THE NEAR–TERM OUTLOOK FOR THE U.S. ECONOMY

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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THE NEAR–TERM OUTLOOK FOR THE U.S. ECONOMY

THURSDAY, JANUARY 17, 2008

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10:00 a.m., in room 210, Cannon House Office Building, Hon. John M. Spratt Jr. [chairman of the committee] presiding.

Present: Representatives Spratt, DeLauro, Edwards, Cooper, Allen, Schwartz, Kaptur, Becerra, Doggett, Blumenauer, Boyd, McGovern, Tsongas, Andrews, Scott, Etheridge, Hooley, Baird, Moore of Kansas, Bishop, Moore of Wisconsin, Ryan, Barrett, Bonner, Garrett, Diaz-Balart, Hensarling, Lungren, Simpson, McHenry, Mack, Conaway, Campbell, Tiberi, Porter, Alexander, and Smith.

Chairman SPRATT. Call the hearing to order. Chairman Bernanke, thank you for coming today. We welcome you and your staff, and look forward to hearing your perspective on the downturn in our economy, on actions the Fed has taken and has available to it for the future, and on the role of fiscal policy as a complement to monetary policy in order to keep our economy moving.

It has become increasingly clear that our economy is beginning to slow down, entering a slump if not a recession. Here are just a few of the recent signs. Net job creation during December equaled a meager 18,000 jobs. As a result, unemployment spiked, rising from 4.7 percent to 5 percent, a substantial increase for just 1 month.

Consumer spending seems to be losing steam, certainly as indicated by the all-important holiday season. Retail sales in December were expected to be flat, but instead fell four-tenths of a percentage below the prior month.

Foreclosures are being filed at rates not seen in years, home values are falling, and the price of gasoline is over $3 a gallon. American households are getting squeezed on all sides, and certain major corporations are booking record losses, running into billions of dollars. Meanwhile, wholesale prices for 2007 rose 6.3 percent, the highest increase in 26 years.

The Federal Reserve has been responsive to these conditions. You have eased the monetary supply and access to credit, and most forecasters expect further rate reductions to come. But monetary policy has limits, such as inflation, inherent lags due to the time it takes interest rates to translate into spending and investment. And no one wants to be the bearer of bad tidings, but there are om-

inous indicators all around us. And all in all, it seems that a compelling case is emerging for some form of fiscal stimulus on top of the monetary stimulus that the Fed has already provided and will continue to supply.

You acknowledge in your testimony that if fiscal policy action is taken it could be helpful in principle, but you warn us that design and implementation are critically important, as is timing. Speaking for our side, we heed that warning. To borrow a phrase from Larry Summers, we believe that a stimulus plan has to be timely, targeted, and temporary. To be effective, fiscal stimulus needs to be timely, arriving during and not after the downturn, and it needs to be targeted, directed at those most likely to spend it quickly. To be credible, it needs to be temporary, otherwise it runs the risk of becoming counterproductive, of driving up structural deficits and interest rates, and undermining confidence in our commitment to fiscal discipline.

Chairman Bernanke, as we ponder the near term economy, the subject of your presentation today, and the need for counter-cyclical policies, we look to you and the Fed for guidance, and hope that in the course of this hearing you can address a few fundamental questions. First of all, what are your views and the views of the Fed on the ominous signs I have just cited and other indications? Do these portend a recession, or at least a significant decline in the economy?

Next, what actions has the Fed taken to date to avoid the risk of recession? How successful have these been? And is your monetary toolbox, the tools available to you, adequate to the task?

Third, are there limits to the monetary policy that fiscal policy in this case can complement?

Fourth, what monetary and fiscal policies are most likely to be efficacious?

Fifth, to what extent is the distressed market in securitized mortgages and complex financial instruments impeding the economy? If this is a source of the problem, should a counter-cyclical package deal directly with this aspect of the problem?

And finally, how serious is the risk of a downward, vicious spiral in which foreclosures drive down housing prices and low prices complicate workouts, resulting in still more foreclosures and even lower prices?

We look forward to hearing your insights on these and other questions on the strength of the near-term economy. But before you begin, let me turn to Mr. Ryan for his opening statements.

Mr. Ryan.

Mr. RYAN. Thank you, Mr. Chairman. And thank you for organizing this hearing. It is well timed. And I can't think of a more authoritative witness to discuss the state of the economy than you, Chairman Bernanke, and thank for coming.

Clearly, the Fed faces a particularly challenging environment right now. Americans have genuine and legitimate concern about the expectations of slower economic growth in the months ahead. Last week I held 15 listening sessions in my district in Wisconsin. As I would imagine everybody else finds in their districts, the economy was a key topic at every one of these. People are concerned.

Lately, it seems that the Fed has been focused on employment growth as its primary objective. We in Congress are focused on job growth as well, given that we have jurisdiction over fiscal policy. As such, we are all in the midst of discussing a short-term economic growth package. But the Fed has the sole responsibility for monetary policy. And many would argue the primary mandate of the Fed is price stability.

Data released showed that the Consumer Price Index rose more than 4 percent last year, the largest annual increase since 1990. Oil prices have soared, food prices have increased, and just this week the price of gold, which is a traditional hedge against inflation, jumped to a nominal all-time high. Meanwhile, the Fed's softer money policy stance and the prospect of future rate cuts have contributed to a further decline in the dollar, which can raise import prices further, stoking inflation. My concern is that these interest rate cuts could lead to even more inflation down the road. And history has shown that once inflation pressures are in the pipeline and expectations rise, they can prove costly to deal with. The Fed risks having to put the brake on economic growth later on via higher interest rates in order to wring that inflation out of the system.

In your testimony, Chairman Bernanke, you point to the Fed's dual mandate of promoting maximum sustainable employment and price stability. In this respect, it is appropriate to highlight the balance of risks associated with policy reactions and to make sure that the benefits of any short-term measures are not dwarfed by the costs of our long-term economic health. Meanwhile, Congress and the administration, Republicans and Democrats, are considering additional responses to the fiscal policy. And like you, we face similar risks and trade-offs.

In considering our strategy for crafting an economic growth plan, there are several key principles that we need to keep in mind. First, do no harm. I am concerned that in our rush to help we talk ourselves into a quick feel good hit today that will leave us with a bigger budgetary hangover tomorrow.

The worst thing we can do right now is raise taxes. And we simply cannot spend our way into prosperity. Whatever short-term responses Congress undertakes should aim at reinforcing the prospects for long-term, sustainable growth.

Second, we ought to play to our strengths. The strength of our economy lies in its people, its innovation, productivity, and resilience, and all flow from sound policies aimed at sustained growth. These policies include a low tax burden and a stable rate of inflation, a reliance on the private sector before the government, an attractive investment climate, and a dynamic labor force. Growth also requires tax certainty so that American businesses and families can count on the future. And Congress can do something about this. Right now Congress can act to make the current tax laws permanent, thereby avoiding the largest tax increase in our Nation's history. And we can address the AMT earlier this year, giving middle class families peace of mind that they won't face a much higher tax bill next year. Unfortunately, I understand the majority has already taken that particular growth proposal off the table.

And finally, we should not add to our entitlement crisis. I am particularly concerned that Congress may be tempted to use the excuse of fiscal stimulus in the short run to push through new entitlement spending proposals, further worsening the outlook for these programs, building up the spending baseline that worsen our economic future. Expert after expert has warned this committee that our largest entitlement programs, particularly Social Security, Medicare, Medicaid, pose the greatest threat to our Nation's future prosperity, and this problem will remain long after the economy works through its near-term problems.

In short, we believe that in addressing the current economic concerns we have got to keep our focus on good economic policy that lasts beyond the next few quarters, that is consistent with long-term growth. And that is the best recipe for long-term sustainable economic growth, which ought to be our ultimate goal.

This is a very well-timed hearing. And Mr. Chairman, I appreciate you having this hearing at this time. And I look forward to your testimony, Chairman Bernanke.

Chairman SPRATT. Thank you, Mr. Ryan. And let me ask unanimous consent that all members be allowed to enter, if they wish, an opening statement for the record at this point. Without objection, so ordered.

[The prepared statement of Ms. Kaptur follows:]

PREPARED STATEMENT OF HON. MARCY KAPTUR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

I would like to thank Chairman Spratt and Ranking Member Ryun for this timely hearing. I would also like to extend my thanks to Chairman Bernanke, whose insight into the current economic downturn is invaluable. It heartens me that this body, and the Fed, have recognized the anguish of the American people, who are facing dire circumstances, soaring inflation, and a possibly bleak economic outlook. I hope that as a result of this hearing, the steps Congress can take to rectify this situation will become more obvious, and that Congress can work closely with the Fed to effectively stimulate the economy in the short term, and to regain American financial security in the long term.

America is facing an economic situation that has the potential to be catastrophic. Because of the poor judgment and intense greed of a few banks, companies, organizations, and, indeed, politicians, the average American has been thrust into economic insecurity. The sub-prime mortgage crisis, perpetuated by profit-hungry lenders and those who traded these loans, contributed heavily to the problems we are discussing today. But the problem is larger than just the housing bubble—the problem lies in the securitized culture of lending and in the inherent flaws of the global finance system in its current incarnation.

People in my district are not simply suffering because of the rising foreclosure rates—though Ohio ranks among the top three states for foreclosures—they are facing a more general economic downturn, or, dare I say it, recession, and must watch while Wall Street and even the American government parcel off our national security and sell it to the highest bidder.

As a result of faulty judgment, bad planning, and corporate greed, the mortgage crisis has taken a huge chunk from Citigroup, Merrill Lynch, J.P. Morgan, and the rest of Wall Street. Now, these banks are turning to Saudi princes, Chinese banks, and the government of Singapore to come to their aid.

I realize, Chairman Spratt, that Chairman Bernanke can only influence monetary policy, but I will be eager to hear his thoughts on possibilities for fiscal stimulus. In my view, we must focus on using infrastructure projects to create jobs, we must encourage Americans to spend, but to spend on American products and American agriculture, and we must curb our reliance on foreign companies and governments to bail us out and become further and further indebted to their interests.

I look forward to working with Chairman Bernanke and with this Committee to bring new, lasting wealth to the people of Ohio's Ninth Congressional District, and to working Americans around the country.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF HON. ADRIAN SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Good morning. There are a number of challenges facing our economy, and I thank you, Chairman, for holding this hearing today on the Near-Term Outlook for the U.S. Economy.

As Congress begins the fiscal year 2009 budget process, we must rise to address our economic challenges in a bipartisan fashion. Rushing to a solution, however, could prove more costly than our current situation. We must not hamstring our economy by increasing taxes to pay for more federal spending, as some have suggested.

We must ensure the prosperity of the last several years continues for future generations. It is my sincere desire to see Congress take the steps necessary to reduce spending and instead stimulate economic growth.

I appreciate the Committee for holding this hearing today. Thank you to Chairman Bernanke for testifying before the Committee. What we learn here today will play a critical role in the decisions we make for the future of the country.

Chairman, I look forward to continuing to work with you to achieve real economic growth, and I thank you for your time.

Mr. Chairman, again, we welcome you to the hearing today. And let me note for the record that your complete testimony will be filed and made part of the record. You can summarize it as you see fit, but the floor is yours. Thank you again for coming. We look forward to your testimony.

STATEMENT OF BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you, Chairman Spratt, Representative Ryan, and other members of the committee. I am pleased to be here to offer my views on the near-term economic outlook and related issues. Since late last summer, financial markets in the United States and in a number of other industrialized countries have been under considerable strain. Heightened investor concerns about the credit quality of mortgages, especially subprime mortgages with adjustable interest rates, triggered the financial turmoil. Notably, as the rising rate of delinquencies of subprime mortgages threatened to impose losses on holders of even highly rated securities, investors were led to question the reliability of the credit ratings for a range of financial products, including structured credit products and various special purpose vehicles. As investors lost confidence in their ability to value complex financial products, they became increasingly unwilling to hold such instruments. As a result, flows of credit through these vehicles have contracted significantly.

As these problems multiplied, money center banks and other large financial institutions, which in many cases had served as sponsors of these financial products, came under increasing pressure to take the assets of the off-balance-sheet vehicles onto their own balance sheets. Bank balance sheets were swelled further by holdings of nonconforming mortgages, leveraged loans, and other credits that the banks had extended but for which well-functioning secondary markets no longer existed. Even as their balance sheets expanded, banks began to report large losses, reflecting marked declines in the market prices of mortgages and other assets. Thus, banks too became subject to valuation uncertainty, as could be seen in the sharp movements in their share prices and in other market

indicators such as quotes on credit default swaps. The combination of larger balance sheets and unexpected losses prompted banks to become protective of their liquidity and balance sheet capacity, and thus to become less willing to provide funding to other market participants, including other banks. Banks have also evidently become more restrictive in their lending to firms and households. More expensive and less available credit seems likely to impose a measure of restraint on economic growth.

To date, the largest effects of the financial turmoil appear to have been on the housing market, which, as you know, has deteriorated significantly over the past 2 years or so. The virtual shutdown of the subprime mortgage market and a widening of spreads on jumbo mortgage loans have further reduced the demand for housing, while foreclosures are adding to the already elevated inventory of unsold homes. New home sales and housing starts have both fallen by about half from their respective peaks. The number of homes in inventory has begun to edge down, but at the current sales pace the months' supply of new homes has continued to climb, and home prices are falling in many parts of the country. The slowing in residential construction, which subtracted about one percentage point of growth from the growth rate of real domestic product in the third quarter of 2007, likely curtailed growth even more in the fourth quarter, and it may continue to be a drag on growth for a good part of this year as well.

Recently, incoming information has suggested that the baseline outlook for real activity in 2008 has worsened, and that the downside risks to growth have become more pronounced. In particular, a number of factors, including continuing increases in energy prices, lower equity prices, and softening home values, seem likely to weigh on consumer spending as we move into 2008. Consumer spending also depends importantly on the state of the labor market, as wages and salaries are the primary source of income for most households. Labor market conditions in December were disappointing. The unemployment rate increased by three-tenths of a percentage point to 5.0 percent from 4.7 percent in November, and private payroll employment declined. Employment in residential construction posted another substantial reduction, and employment in manufacturing and retail trade has also decreased significantly. Employment in services continued to grow, but at a slower pace in December than in earlier months. It would be a mistake to read too much into 1 month's data. However, developments in the labor market will bear close attention.

In the business sector, investment in equipment and software appears to have been sluggish in the fourth quarter, while nonresidential construction grew briskly. In light of the softening in economic activity and the adverse developments in credit markets, growth in both types of investment spending seem likely to slow in coming months. Outside the United States, however, economic activity in our major trading partners has continued to expand vigorously. U.S. exports will likely continue to grow at a healthy pace in coming quarters, providing some impetus to the domestic economy.

Financial conditions continue to pose a downside risk to the outlook. Market participants still express considerable uncertainty

about the appropriate valuation of complex financial assets and about the extent of additional losses that may be disclosed in the future. On the whole, despite improvements in some areas, the financial situation remains fragile, and many funding markets remain impaired. Adverse economic or financial news thus has the potential to increase financial strains and to lead to further constraints on the supply of credit to households and businesses.

Even as the outlook for real activity has weakened, some important developments have occurred on the inflation front. Most notably, the same increase in oil prices that may be a negative influence on growth is also lifting overall consumer prices. Last year, food prices also increased exceptionally rapidly by recent standards, further boosting overall consumer price inflation. The most recent reading on overall personal consumption expenditure inflation showed that prices in November were 3.6 percent higher than they were a year earlier. Core price inflation, which excludes prices of food and energy, has stepped up recently as well, with November prices up almost 2¼ percent from a year earlier. Part of this rise may reflect pass-through of energy costs to the prices of core consumer goods and services, as well as the effects of the depreciation of the dollar on import prices, although some other prices, such as those for some medical and financial services, have also accelerated lately.

Thus far, the public's expectations of future inflation appear to remain reasonably well anchored, and pressures on resource utilization have diminished a bit. Further, futures markets suggests that food and energy prices will decelerate over the coming year. Given these factors, overall and core inflation should moderate this year and next, so long as the public's confidence in the Federal Reserve's commitment to price stability is unshaken. However, any tendency of inflation expectations to become unmoored or for the Fed's inflation-fighting credibility to be eroded could greatly complicate the task of sustaining price stability and would reduce the central bank's policy flexibility to counter shortfalls in growth in the future. Accordingly, in the months ahead we will be closely monitoring the inflation situation, particularly inflation expectations.

The Federal Reserve has taken a number of steps to help markets return to more orderly functioning and to foster its economic objectives of maximum sustainable employment and price stability. Broadly, the Federal Reserve's response has followed two tracks: Efforts to improve market liquidity and functioning and the pursuit of our macroeconomic objectives through monetary policy.

To help address the significant strains in short-term money markets, the Federal Reserve has taken a range of steps. Notably, on August 17th, The Federal Reserve Board cut the discount rate, the rate at which it lends directly to banks, by 50 basis points, or one-half percentage point, and it has since maintained the spread between the Federal funds rate and the discount rate at 50 basis points rather than the customary 100 basis points. In addition, the Federal Reserve recently unveiled a term auction facility, or TAF, through which prespecified amounts of discount window credit can be auctioned to eligible borrowers. The goal of the TAF is to reduce the incentive for banks to hoard cash, and thus to increase their

willingness to provide credit to households and firms. In December, the Fed successfully auctioned $40 billion through this facility. And, as part of a coordinated operation, the European Central Bank and the Swiss National Bank lent an additional $24 billion to banks in their respective jurisdictions. This month, the Federal Reserve is auctioning $60 billion in 28-day credit through the TAF, to be spread across two auctions. TAF auctions will continue as long as necessary to address elevated pressures in short-term funding markets, and we will continue to work closely and cooperatively with other central banks to address market strains that could hamper the achievement of our broader economic objectives.

Although the TAF and other liquidity-related actions appear to have had some positive effects, such measures alone cannot fully address fundamental concerns about credit quality and valuation, nor do these actions relax the balance sheet constraints on financial institutions. Hence, they alone cannot eliminate the financial restraints affecting the broader economy. Monetary policy; that is, the management of the short-term interest rate, is the Fed's best tool for pursuing our macroeconomic objectives; namely, to promote maximum sustainable employment and price stability.

Monetary policy has responded proactively to evolving conditions. As you know, the Federal Open Market Committee, or FOMC, cut its target for the Federal funds rate by 50 basis points at its September meeting and by 25 basis points each at the October and December meetings. In total, therefore, we have brought the Federal funds rate down by one percentage point from its level just before the financial strains emerged. The Federal Reserve took these actions to help offset the restraint imposed by the tightening of credit conditions and the weakening of the housing market. However, in light of recent changes in the outlook for and the risks to growth, additional policy easing may well be necessary. The FOMC will, of course, be carefully evaluating incoming information bearing on the economic outlook. Based on that evaluation, and consistent with our dual mandate, we stand ready to take substantive additional action as needed to support growth and provide adequate insurance against downside risks.

Financial and economic conditions can change quickly. Consequently, the FOMC must remain exceptionally alert and flexible, prepared to act in a decisive and timely manner and, in particular, to counter any adverse dynamics that might threaten economic or financial stability.

A number of analysts have raised the possibility that fiscal policy actions might usefully complement monetary policy in supporting economic growth over the next year or so. I agree that fiscal action could be helpful in principle, as fiscal and monetary stimulus together may provide broader support for the economy than monetary policy actions alone. But the design and implementation of the fiscal program are critically important. A fiscal initiative at this juncture could prove quite counterproductive if, for example, it provided economic stimulus at the wrong time or compromised fiscal discipline in the longer term.

To be useful, a fiscal stimulus package should be implemented quickly and structured so that its effects on aggregate spending are felt as much as possible within the next 12 months or so. Stimulus

that comes too late will not help support economic activity in the near term, and it could be actively destabilizing if it comes at a time when growth is already improving. Thus, fiscal measures that involve long lead times or result in additional economic activity only over a protracted period, whatever their intrinsic merits might be, will not provide stimulus when it is most needed. Any fiscal package should also be efficient, in the sense of maximizing the amount of near-term stimulus per dollar of increased Federal expenditure or lost revenue. Finally, any program should be explicitly temporary, both to avoid unwanted stimulus beyond the near-term horizon and, importantly, to preclude an increase in the Federal Government's structural budget deficit. As I have discussed on other occasions, the Nation faces daunting long-run budget challenges associated with an aging population, rising healthcare costs, and other factors. A fiscal program that increased the structural budget deficit would only make confronting those challenges more difficult.

Thank you. I would be pleased to take your questions.

[The prepared statement of Ben S. Bernanke follows:]

PREPARED STATEMENT OF BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Chairman Spratt, Representative Ryan, and other members of the Committee, I am pleased to be here to offer my views on the near-term economic outlook and related issues. Developments in Financial Markets

Since late last summer, financial markets in the United States and in a number of other industrialized countries have been under considerable strain. Heightened investor concerns about the credit quality of mortgages, especially subprime mortgages with adjustable interest rates, triggered the financial turmoil. Notably, as the rising rate of delinquencies of subprime mortgages threatened to impose losses on holders of even highly rated securities, investors were led to question the reliability of the credit ratings for a range of financial products, including structured credit products and various special-purpose vehicles. As investors lost confidence in their ability to value complex financial products, they became increasingly unwilling to hold such instruments. As a result, flows of credit through these vehicles have contracted significantly.

As these problems multiplied, money center banks and other large financial institutions, which in many cases had served as sponsors of these financial products, came under increasing pressure to take the assets of the off-balance-sheet vehicles onto their own balance sheets. Bank balance sheets were swelled further by holdings of nonconforming mortgages, leveraged loans, and other credits that the banks had extended but for which well-functioning secondary markets no longer existed. Even as their balance sheets expanded, banks began to report large losses, reflecting marked declines in the market prices of mortgages and other assets. Thus, banks too became subject to valuation uncertainty, as could be seen in the sharp movements in their share prices and in other market indicators such as quotes on credit default swaps. The combination of larger balance sheets and unexpected losses prompted banks to become protective of their liquidity and balance sheet capacity and thus to become less willing to provide funding to other market participants, including other banks. Banks have also evidently become more restrictive in their lending to firms and households. More-expensive and less-available credit seems likely to impose a measure of restraint on economic growth.

THE OUTLOOK FOR THE REAL ECONOMY

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and home prices are falling in many parts of the country. The slowing in residential construction, which subtracted about 1 percentage point from the growth rate of real gross domestic product in the third quarter of 2007, likely curtailed growth even more in the fourth quarter, and it may continue to be a drag on growth for a good part of this year as well.

Recently, incoming information has suggested that the baseline outlook for real activity in 2008 has worsened and that the downside risks to growth have become more pronounced. In particular, a number of factors, including continuing increases in energy prices, lower equity prices, and softening home values, seem likely to weigh on consumer spending as we move into 2008. Consumer spending also depends importantly on the state of the labor market, as wages and salaries are the primary source of income for most households. Labor market conditions in December were disappointing; the unemployment rate increased 0.3 percentage point, to 5.0 percent from 4.7 percent in November, and private payroll employment declined. Employment in residential construction posted another substantial reduction, and employment in manufacturing and retail trade also decreased significantly. Employment in services continued to grow, but at a slower pace in December than in earlier months. It would be a mistake to read too much into one month's data. However, developments in the labor market will bear close attention.

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Financial conditions continue to pose a downside risk to the outlook. Market participants still express considerable uncertainty about the appropriate valuation of complex financial assets and about the extent of additional losses that may be disclosed in the future. On the whole, despite improvements in some areas, the financial situation remains fragile, and many funding markets remain impaired. Adverse economic or financial news thus has the potential to increase financial strains and to lead to further constraints on the supply of credit to households and businesses.

Even as the outlook for real activity has weakened, some important developments have occurred on the inflation front. Most notably, the same increase in oil prices that may be a negative influence on growth is also lifting overall consumer prices. Last year, food prices also increased exceptionally rapidly by recent standards, further boosting overall consumer price inflation. The most recent reading on overall personal consumption expenditure inflation showed that prices in November were 3.6 percent higher than they were a year earlier. Core price inflation (which excludes prices of food and energy) has stepped up recently as well, with November prices up almost 2¼ percent from a year earlier. Part of this rise may reflect pass-through of energy costs to the prices of core consumer goods and services, as well as the effects of the depreciation of the dollar on import prices, although some other prices—such as those for some medical and financial services—have also accelerated lately.[1]

Thus far, the public's expectations of future inflation appear to have remained reasonably well anchored, and pressures on resource utilization have diminished a bit. Further, futures markets suggest that food and energy prices will decelerate over the coming year. Given these factors, overall and core inflation should moderate this year and next, so long as the public's confidence in the Federal Reserve's commitment to price stability is unshaken. However, any tendency of inflation expectations to become unmoored or for the Fed's inflation-fighting credibility to be eroded could greatly complicate the task of sustaining price stability and reduce the central bank's policy flexibility to counter shortfalls in growth in the future. Accordingly, in the months ahead we will be closely monitoring the inflation situation, particularly inflation expectations.

MONETARY POLICY RESPONSE

The Federal Reserve has taken a number of steps to help markets return to more orderly functioning and to foster its economic objectives of maximum sustainable

[1] Prices for some financial services are implicit; for example, depositors may pay for "free" checking services only indirectly, by accepting a lower interest rate on their deposits. The Bureau of Labor Statistics uses estimates of such prices, as well as other nonmarket prices, in calculating the inflation rate.

employment and price stability. Broadly, the Federal Reserve's response has followed two tracks: efforts to improve market liquidity and functioning and the pursuit of our macroeconomic objectives through monetary policy.

To help address the significant strains in short-term money markets, the Federal Reserve has taken a range of steps. Notably, on August 17, the Federal Reserve Board cut the discount rate—the rate at which it lends directly to banks—by 50 basis points, or ½ percentage point, and it has since maintained the spread between the federal funds rate and the discount rate at 50 basis points, rather than the customary 100 basis points. In addition, the Federal Reserve recently unveiled a term auction facility, or TAF, through which prespecified amounts of discount window credit can be auctioned to eligible borrowers. The goal of the TAF is to reduce the incentive for banks to hoard cash and increase their willingness to provide credit to households and firms. In December, the Fed successfully auctioned $40 billion through this facility. And, as part of a coordinated operation, the European Central Bank and the Swiss National Bank lent an additional $24 billion to banks in their respective jurisdictions. This month, the Federal Reserve is auctioning $60 billion in twenty-eight-day credit through the TAF, to be spread across two auctions. TAF auctions will continue as long as necessary to address elevated pressures in short-term funding markets, and we will continue to work closely and cooperatively with other central banks to address market strains that could hamper the achievement of our broader economic objectives.

Although the TAF and other liquidity-related actions appear to have had some positive effects, such measures alone cannot fully address fundamental concerns about credit quality and valuation, nor do these actions relax the balance sheet constraints on financial institutions. Hence, they alone cannot eliminate the financial restraints affecting the broader economy. Monetary policy (that is, the management of the short-term interest rate) is the Fed's best tool for pursuing our macroeconomic objectives, namely to promote maximum sustainable employment and price stability.

Monetary policy has responded proactively to evolving conditions. As you know, the Federal Open Market Committee (FOMC) cut its target for the federal funds rate by 50 basis points at its September meeting and by 25 basis points each at the October and December meetings. In total, therefore, we have brought the federal funds rate down by 1 percentage point from its level just before the financial strains emerged. The Federal Reserve took these actions to help offset the restraint imposed by the tightening of credit conditions and the weakening of the housing market. However, in light of recent changes in the outlook for and the risks to growth, additional policy easing may well be necessary. The FOMC will, of course, be carefully evaluating incoming information bearing on the economic outlook. Based on that evaluation, and consistent with our dual mandate, we stand ready to take substantive additional action as needed to support growth and to provide adequate insurance against downside risks.

Financial and economic conditions can change quickly. Consequently, the FOMC must remain exceptionally alert and flexible, prepared to act in a decisive and timely manner and, in particular, to counter any adverse dynamics that might threaten economic or financial stability.

A number of analysts have raised the possibility that fiscal policy actions might usefully complement monetary policy in supporting economic growth over the next year or so. I agree that fiscal action could be helpful in principle, as fiscal and monetary stimulus together may provide broader support for the economy than monetary policy actions alone. But the design and implementation of the fiscal program are critically important. A fiscal initiative at this juncture could prove quite counterproductive, if (for example) it provided economic stimulus at the wrong time or compromised fiscal discipline in the longer term.

To be useful, a fiscal stimulus package should be implemented quickly and structured so that its effects on aggregate spending are felt as much as possible within the next twelve months or so. Stimulus that comes too late will not help support economic activity in the near term, and it could be actively destabilizing if it comes at a time when growth is already improving. Thus, fiscal measures that involve long lead times or result in additional economic activity only over a protracted period, whatever their intrinsic merits might be, will not provide stimulus when it is most needed. Any fiscal package should also be efficient, in the sense of maximizing the amount of near-term stimulus per dollar of increased federal expenditure or lost revenue. Finally, any program should be explicitly temporary, both to avoid unwanted stimulus beyond the near-term horizon and, importantly, to preclude an increase in the federal government's structural budget deficit. As I have discussed on other occasions, the nation faces daunting long-run budget challenges associated with an aging population, rising health-care costs, and other factors. A fiscal program that

increased the structural budget deficit would only make confronting those challenges more difficult.

Thank you. I would be pleased to take your questions.

Chairman SPRATT. Thank you, Mr. Chairman. I note that you have to be careful in the terms you use, and in particular of using terms that might become self-fulfilling prophecies. But as you look at all of these dire conditions and the recent events that I described just earlier, how does the Fed sum it up? What is the Fed's overall diagnosis of the course of the economy over the next year to 18 months?

Mr. BERNANKE. Well, we currently see the economy as continuing to grow, but growing at a relatively slow pace, particularly in the first half of this year. As the housing contraction begins to wane, as it should sometime during this year, the economy should pick up a bit later in this year. But we believe we will see below-trend growth certainly in 2008, and probably early into 2009 as well.

Chairman SPRATT. You indicate in your testimony that conditions appear to be worsening in 2008?

Mr. BERNANKE. Yes. The latter half of 2007 was actually reasonably good. The third quarter we saw growth of about 5 percent. Growth slowed significantly in the fourth quarter, but is still moderate. Recent indications suggest, though, that the economy has softened somewhat, and that the growth prospects for 2008 are certainly below that of last year.

Chairman SPRATT. But as I listened to you read the first several pages of your testimony describing the conditions in the financial markets in particular, the swollen nonconforming mortgage portfolios, the lack of investor confidence in the valuation of their investments, then the lack of confidence in institutions holding those assets, a long litany of fairly distinct and unique problems, it doesn't appear to be your garden variety business cycle recession of the kind we were used to in the years after the end of the last war.

Mr. BERNANKE. Well, again, we are not forecasting recession, but rather at this point slow growth. But you are absolutely correct, Mr. Chairman, that there are a number of characteristics of this period that are somewhat unique, including the financial market turmoil we have seen, pressures on the banks. We are hit on the other side by these rapid increases in oil and commodity prices, which create some inflation risk and create a problem on that side. The housing sector, of course, has been in a very sharp contraction and relatively unusual pattern that we have seen there as well. So there really is a confluence of different events that makes this a difficult combination of circumstances.

I think it is important, as we are concerned about the slowing growth of the economy, that the U.S. economy remains extraordinarily resilient. It is very diversified. It has a strong labor force, excellent productivity and technology, and a deep and liquid financial market that is in the process of trying to repair itself. So I think we need to keep in mind also that the economy does have inherent strengths, and that those will certainly surface over a period of time.

Chairman SPRATT. Would you agree that the confluence, as you put it, of these dire events calls for something broader than mone-

tary policy, and gives us particular reason for using a fiscal policy stimulus in this particular set of circumstances?

Mr. BERNANKE. As I said, Mr. Chairman, I think a fiscal stimulus package could be helpful in the current circumstances. It would provide a broader base of support to the economy than just that afforded by monetary policy. It would in some sense diversify our policy tools as we attempt to address the situation. It might have somewhat different timing, different effects over—on the economy than monetary policy. So I think it could be helpful. But as I emphasized in my testimony, it needs to be done quickly, to be temporary, and to be effective in the sense that for every dollar put into stimulus we get a reasonable response in terms of extra activity during the next year or so.

Chairman SPRATT. Given the structural problems in the financial markets, do you think that the fiscal policy solution or package should go to the source of the problem, as you put it, where the existing events were triggered, and attempt some sort of structural fix as well as providing some aggregate demand increases?

Mr. BERNANKE. Well, there are a whole range of issues that we will be looking at over the next couple of years. And the financial markets will be wanting to review whether regulatory and accounting policies need to be changed in light of what we have seen in the last couple of years. I am sure there will be continued attention to the housing market and mortgage market and the issues that were raised in the recent experience there. But I think from the perspective of fiscal stimulus, if we are able to provide some additional strengths in the near term in the economy, that that will be beneficial broadly. For example, if the economy is growing more quickly, then the stresses on the housing market, on the financial market would be correspondingly reduced.

Chairman SPRATT. Could you take just a second and explain to us how it is that a problem so pervasive and so serious was able to crop up or arrive under the radar without being detected sooner by the regulators?

Mr. BERNANKE. Well, there was—as I said, there was a combination of factors. The economy was reaching its full employment point a couple years ago, and the Federal Reserve was very focused on trying to help the economy go along an expansion path without inflation. We were very focused on that. But we have, just as I said, a confluence of factors. One of the key factors has been the housing boom and bust that we have seen. House prices and house construction are obviously on the down trend. That in turn has interacted with mortgage markets, and particularly subprime mortgages, as I have discussed, and created—particularly in the category of subprime mortgages with adjustable rates, has created high rates of delinquency. That in turn has fed into the financial system and created pressures in the banking sector which are then being felt in terms of their profitability, their capital, and their willingness to extend credit. So it has been a complicated interaction of factors that have led to this situation.

Chairman SPRATT. Has the prevalence of securitized mortgage packages made it more difficult to find a regulatory solution to the problems in the financial market?

Mr. BERNANKE. In some respects it has. Mortgages are no longer generally held by the lender who made the mortgage. Instead, the mortgages have been sliced and diced and sold throughout the financial system as part of structured credit products, or as part of mortgage-backed securities. We have found some complexity arising from that in terms of loan modifications and workouts. It has been somewhat more difficult for the servicer to work out a loan with a troubled borrower when the servicer doesn't own the mortgage. It has to essentially meet the requirements and the interests of all the holders of the mortgage.

We at the Federal Reserve, along with the other regulators, have been working hard trying to find solutions to that. We have tried to address technical problems such as accounting rules that might impede servicers from modifying loans. We have provided letters of encouragement essentially to servicers and to banks encouraging them to do loan modifications wherever feasible. Of course the Treasury and the HUD have undertaken this HOPE NOW initiative to try to increase the scale and scope of renegotiation and loan modifications.

So there are many efforts underway to try and increase the scale and to address more effectively the problem of troubled borrowers. But I think it is fair to say that the securitization and the distribution of mortgage ownership very widely has to some extent complicated that process, and that is something we will have to be thinking about as we review the lessons of this period.

Chairman SPRATT. One final question, just to go back over your testimony, as to the contents and configuration of a fiscal stimulus policy package, what do you think the contents should be? I know you can't get prescriptive of a specific, but could you give us a broad outline? And in particular, can you address at all whether or not the structural package should include the renewal of the expiring tax cuts?

Mr. BERNANKE. Mr. Chairman, I, as you know, in light of the nonpartisan character of the Federal Reserve, I am going to try very hard today to avoid taking positions in favor of any specific tax or——

Chairman SPRATT. I wanted to offer you the opportunity, but I understand your reasons.

Mr. BERNANKE. But I do think that you should be looking at a number of different things that—a program that combine a number of elements, you know, might in some sense address the problem from a number of different angles and be more effective than one that was only a single element.

Chairman SPRATT. Thank you, sir.

Mr. Ryan.

Mr. RYAN. Thank you, Chairman. Mr. Chairman, I find it interesting that Europe is also facing signs of a slowdown in growth and feeling the effects of the credit market turmoil, yet last week the European Central Bank opted not to lower interest rates due to its concerns over inflation. To what should we attribute the difference in policy action between the Fed and the ECB given somewhat similar economic circumstances?

Mr. BERNANKE. Well, I don't think the circumstances are entirely similar. In particular, Europe has not faced this 2-year decline in

the housing market, with all its implications for construction activity, for construction jobs, for homeowners' prices—homeowners' equity, and for the credit quality of mortgages in the banks. They have experienced some credit issues, in part because of the international nature of financial markets. And some have worried that that might imply some restraint on their economies. But we at the Federal Reserve, we follow, of course, all of our major trading partners, and we try to develop forecasts and analyses of their economies. And we do not see in Asia or in Europe the slowdown in growth that potentially we will be seeing here in the United States. And so I think the circumstances are rather different. And that, you know, potentially leads to a different policy response.

Mr. RYAN. Has the Fed given us an estimate, or has the Fed come up with an estimate of the total dollar value loss associated with the housing correction and the subprime market fallout?

Mr. BERNANKE. Well, you hear a lot of numbers being cast about. And I think part of the problem is that people are comparing apples and oranges. Some people want to include not just losses in the subprime mortgage area, but throughout all credit areas.

Mr. RYAN. Right.

Mr. BERNANKE. Some people are double counting because they are counting not only the credit losses, but also the losses to the holders of derivatives, the credit default swaps and the like. So there are a lot of numbers out there which are not really comparable.

So the facts are the following, that in the subprime adjustable rate mortgage market there are about 5 million mortgages, with a total market value of—a total principal value of about a trillion dollars. Currently, about 20 percent of those mortgages are delinquent. If you assume that all of those mortgages go into foreclosure, which is an exaggeration, and you are pessimistic about recovery and say that only 50 percent of the value will be recovered, that would give you so far about a hundred billion dollars in losses in that category.

Now, our expectations is that delinquencies will go higher and that there will be ongoing losses in the subprime area. There are also moderate additional losses in, for example, subprime mortgages with fixed rates and in other mortgages as well. But the thrust, the largest part of the problem so far has been in subprime mortgages with adjustable rates. As I said, I see so far about a hundred billion dollars, but it could be certainly several multiples of that as we go forward, and the delinquency rates and foreclosure rates rise.

Mr. RYAN. So to try and get an assessment of that specific damage, we are looking at a hundred billion now, possibly more hundreds, but not eclipsing the trillion dollar mark in an economy, a $14 trillion economy. Is that just the proper way to put this into perspective?

Mr. BERNANKE. That is correct. Within the specific category of subprime adjustable rate mortgages, the total outstandings are about a trillion dollars, so the limits to possible losses——

Mr. RYAN. Right.

Mr. BERNANKE [continuing]. Must be less than half of that.

Mr. RYAN. So given that you have these different tools in your toolbox, you have the discount window, you have the TAFs, and then you have just broad interest rate policy, are you concerned that there is a point at which a moral hazard occurs with these policies? The discount window and the TAF is more of a liquidity-producing policy, but the broader interest rate policy, do you fear that this could reignite another housing bubble down the road if the Fed goes too far and creates a moral hazard within those policies?

Mr. BERNANKE. Well, we are going to be certainly alert to moral hazard issues. But at the moment, I don't think that is a major concern for a couple of reasons. First of all, let me just say in terms of what our objectives are, as I talked about in my remarks, for example, in Jackson Hole in August, it is not the Federal Reserve's job to protect investors from decisions they made. And we are certainly not trying to do that. However, we do want to make sure that if the financial markets are in distress, that that distress does not result in innocent bystanders, so to speak, the rest of the economy, suffering. And therefore, we do want to try to address the problem of keeping the economy as stable as possible.

Recently, the interbank markets have been quite dysfunctional; that is, interest rates that banks lend to each other have been quite high. That reduces the effectiveness of monetary policy. That makes banks much less willing to lend. And therefore, it is counterproductive from the point of view of our objectives of stabilizing the economy. Our liquidity measures have attempted to reduce those tensions. And I think we have had some success in that direction, which is very positive, will make banks more willing to lend and will help strengthen the economy going forward.

With respect to moral hazard, again, as I said, we certainly have not prevented banks from taking losses, as you can see by the write-downs that have been coming for the last several months now. And I would say in addition, that as we go forward and as we look at the new bank regulations under Basel II and so on, that we are going to want to be particularly sure going forward that banks maintain adequate liquidity, adequate capital. And so we will directly ensure that they are not taking advantage of this program to skimp on their necessary protective measures.

Mr. RYAN. On the inflation side of the ledger book, can you give us a good sense of how we ought to measure inflationary expectations? You know, we are using the traditional measurements, we see gold at a nominal all time high, we see other commodity prices that are post-cyclical indicators showing us possible concerns of inflation. In your testimony you mention that you think we will see a deceleration of those prices in the second half of this year. We really haven't had to deal with this since the Volcker era. And so this is new. And the economy is global and different than it was during that Volcker era. What does the Fed look at to try and measure inflationary expectations? Because if those expectations come into the economy then we have a real problem on our hands. And I am assuming you would have to have a tightening regime to follow. So what is it that the Fed looks at to measure expectations in this new global economy we have?

Mr. BERNANKE. Congressman, you make a very good point. We do look at variables like gold and other commodities. They do have some information in them. But it is not pure information about inflation because gold, for example, responds to a whole variety of concerns, geopolitical and others. Commodities have been rising certainly in significant part because of the increased demands by China and India and other emerging market economies for these inputs. So that is by itself, I think, not sufficient to evaluate the inflation situation.

We generally have two sources of information about expectations. The first comes from financial markets. There are a number of different financial instruments that give some information about inflation expectations.

Mr. RYAN. Futures contracts, things like that?

Mr. BERNANKE. The one that is most clear is the return on the Treasury Inflation-Protected Securities, the TIPS, bonds. By comparing the yields on TIPS bonds to non-indexed bonds you can get an assessment of what investors think that long-term inflation expectations are going to be—long-term inflation is going to be. When you do that, you find that investors have not ratcheted up their expectations for long-term inflation, which is somewhat encouraging.

The other type of information we get is through various surveys of either firms or households, asking people directly what their expectations are. And what we see there is that people have increased their inflation expectations for the very near term, which is understandable given what is happening to oil prices, and therefore to gasoline prices. But generally speaking, both firms and households have kept pretty much unchanged their views of what inflation is likely to be over the longer period, say the next 5 to 10 years. And we take some comfort from that as well.

But having said that, we recognize that inflation expectations are not fixed. They depend on our policies and our actions, and it is very important for us to keep a close eye on inflation as we go forward.

Mr. RYAN. Yes. I think the concern is that it will happen so fast before it—you know, after it is too late to do anything about it. So I guess the final question is—I want to be sensitive to other members' time, I know you have a hard leave time—is do you believe that your indicators, these tools you use to measure expectations give you enough lead time to make the policy adjustments necessary to prevent inflation?

Mr. BERNANKE. I believe they do. Besides those expectational measures, we obviously have direct measures of inflation and price change, and we monitor those very closely. And we use things like the futures markets, as you mentioned. So inflation generally moves in a fairly slow way, at least the underlying inflation. We are watching it very carefully. And it has got to be part of the equation as we look forward and try to judge our policy actions.

Mr. RYAN. Thank you, Mr. Chairman. I yield.

Chairman SPRATT. Thank you, Mr. Ryan. We may have votes on the floor. In that event, unless they are serious votes, I plan to continue the meeting, the hearing onward because the Chairman has to leave at 12:30 today.

Mr. Edwards of Texas.

Mr. EDWARDS. Chairman Bernanke, to address our present short-term economic challenges some in Congress have suggested that we make permanent tax cuts that aren't scheduled to expire until 2010. I have two questions to you regarding that proposal. One, in your opinion, without talking about the long-term consequences of that, in your opinion would making permanent tax cuts that aren't going to expire for 3 years, would that have any significant impact on our present economic slowdown?

And my second question is given your focus and your testimony and importance of maintaining long-term fiscal discipline, if these tax cuts scheduled for 3 years, that would start going into effect 3 years from now, if they are not paid for by spending cuts or other tax increases, if they are paid for primarily by borrowing money, including borrowing from foreign nations and by significantly increasing the Federal deficit, is there a risk that that policy could actually hurt future economic growth?

Mr. BERNANKE. Well, Congressman, it is possible that making the tax cuts permanent might have some near-term effect. For example, making dividend relief permanent could affect today's stock market as the market looks forward in terms of dividend payments. But I think there is a whole range of issues, including tax policy, budget balance, tax reform that the Congress has to look at, entitlements, which are very important, but also very long run in nature. And I think those who support making the President's tax cuts permanent would say that the primary reasons for advocating that would be for long-term growth purposes. And so, you know, our discussion today is about short-term stimulus. And I think from the point of view of getting stimulus in the next few months, I think that the evidence suggests that measures that involve putting money in the hands of households and firms that will spend it in the near term would be more effective.

Again, I am not taking a view one way or the other on the desirability of those long-term tax cuts being made permanent. But I think they are a part of a set of very important long-term issues on fiscal structure and fiscal stability that this committee and the Congress needs to have.

Mr. EDWARDS. Could you address for a moment a bit more specifically my second question, that if those tax cuts were not paid for by other spending cuts or tax increases, they were paid for by increasing the Federal deficit significantly and by borrowing money from others, including foreign nations, could that actually harm long-term economic growth in this country?

Mr. BERNANKE. Well, I will answer this way, which is I think that we need to have long-term fiscal responsibility. And so those who want to have low taxes, and low taxes have many benefits, also need to support a very disciplined spending side as well. Those who want to spend more need to find the revenues to support that. So as I have said a number of occasions, the law I am most in favor of is the law of arithmetic. That, you know, what comes in at least has to equal what goes out at some point. And as you think about the various alternatives that the Congress has over the longer period, I hope the law of arithmetic will be part of your consideration.

Mr. EDWARDS. Perhaps that is a law we should pass in Congress. Mr. Chairman, could I ask in just the 1 minute remaining that I

have, some have said that in a $14 trillion economy, a hundred billion dollar stimulus package would be nothing but window dressing. You testified a moment ago that if done properly, it could actually assist us in trying to improve our present economic situation. Would that impact, a hundred billion dollars in a $14 trillion economy, be directly economic or psychological on improving consumer confidence? What would be the potential positive impact of a hundred billion dollar or so stimulus package?

Mr. BERNANKE. It would be—it would be significant. If you did a hundred billion dollars of stimulus, and let us say for sake of argument that 60 or 70 billion of that was actually spent by say early 2009, and that was added to the GDP, that the effects on the growth rates in the second half of the year and early 2009 would be significant. It would be certainly measurable, would not be window dressing.

Mr. EDWARDS. Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Garrett?

Mr. GARRETT. Thank you, Mr. Chairman. And I appreciate your holding the hearing. And I would like to thank Chairman Bernanke as well for your testimony so far. As we all know, one of the main reasons we are facing these current economic downturns, as you already indicated, is the housing market. And while I know there has been a lot of criticism by some as to why we, if you want to say that, the government didn't act any sooner or faster to head it off, as you indicated, and others have said as well, many people never saw the breadth of the problem we are currently experiencing coming. Even your predecessor, Mr. Greenspan, was under the false impression that a decline in the housing industry could precipitate broader economic problems. In February of 2005, I asked that then-Chairman about the possibility of a nationwide housing bubble, not in this committee but over in Financial Services. He responded, saying, I think we are running into certain problems in certain localized areas. We do not have the characteristics of a bubble in certain areas—or we do have the characteristics of a bubble in certain areas, but not, as best as I can judge, nationwide. I don't expect that we will run into anything resembling a collapsing bubble. I do believe that it is conceivable we will get some reduction in overall prices than we have had in the past, but that is not a particular problem.

It is obvious it has become a problem, and I want to compliment you now for your—and your colleagues at the Fed for your hard work, for example, in a proposed rule to amend the provisions of Regulation Z in an effort to prevent some of the bad practices that have occurred in the mortgage market over the last several years from happening again.

I also want to applaud the administration and the Treasury Secretary Paulson for their efforts in bringing together all the different participants in the mortgage loan process to work with each other under HOPE NOW. It is to keep more people in their homes, provide investors a maximum return on their investment, and prevent the current mortgage market from trickling into other parts of the economy.

That said, while I am pleased with the appropriate government agencies that are focusing on the issues, I do want to issue a word

of caution. Whenever the government overly interferes with the marketplace there is a potential, as Mr. Ryan has already indicated, I believe, that a so-called moral hazard that can affect future economic decisions and transactions. It is very plausible to suggest that if government bails everyone out of this mess that we will continue to bail out bad actors in the future, and any market discipline that currently remains will further erode.

Now, two or three questions I have in my time here. On the last point that was just raised, would the possibility of a stimulus package that would consist of infusing the number was thrown out about a hundred billion dollars, and what impact it would have, you suggested that would have some impact—I don't know whether you used the word "significant" or not—and you suggested that about 60-some odd percent of it might be actually used for current spending. I think we have to go by history on that to see what has occurred in the past. My understanding in the past was that when the dollars were given back out earlier in this decade that about a third of it went to pay off credit card debt and other debt, which is what I think most Americans would do right now, especially if you are in a foreclosure. Another third of it just went into savings accounts or otherwise. Basically, two-thirds of the money was set aside and was not any stimulus package at all. The remaining amount of money, therefore, was left over. And that was only a third of the percentage of the dollars spent. So if we gave everybody a hundred dollars, that means they would have about $30 to spend to go out and buy a toaster of some sort.

So my first question is where do you come up with the suggestion that this time around there would be twice as much revenue spent than we have had in the past occasions?

My other question goes to a comment that you made back in November. November 8th, in your testimony before the Joint Economic Committee, you said that a large increase in net taxes would tend to be a drag on consumer spending and on the economy through a number of different channels. So my question here is in the light of the fact that we may have some suggestions of offsetting any spending packages that we do here, perhaps potentially with taxes, do you still believe an increase in taxes would have such a deleterious impact on the overall economy?

Mr. BERNANKE. Thank you, Congressman. Well, first on the magnitudes, let me just say first of all that there is a lot of uncertainty about exactly what the spending impact would be. And there is a range of estimates out there. There has been some very interesting recent work that looks at credit card balances and how the credit card balances adjusted after the checks were disbursed in 2001, which suggests a somewhat higher response than I think you were indicating. And that is described—the Congressional Budget Office has a recent publication which gives a nice overview of some of the issues and some of the evidence relating to different types of spending impacts. But I certainly take your point that there is a lot of uncertainty in terms of how big the effect would be and how quickly it would be felt, which is one of the reasons for considering perhaps a combination of issues, a combination of programs to kind of diversify your risk, so to speak.

My presumption is that if this stimulus package was undertaken, and again to be of value it would need to be timely and well implemented and well designed, that it would result in a near-term increase in the budget deficit, and not an increase in taxes. That would be counterproductive to increase taxes as part of this program. There could be offsets, you know, at further horizons. And so this could or could not, may or may not be consistent with the PAYGO approach, for example. But certainly to be effective under the usual analysis it would have to increase the deficit in the near term.

Chairman SPRATT. Mr. Cooper of Tennessee.

Mr. COOPER. Thank you, Mr. Chairman. Mr. Chairman, I welcome your testimony. Thank you for giving Congress some guidance on the outlines of an overall stimulus package. I think most of us agree with you that it should be timely and well designed. I am hoping that we are not only getting a congressional-Fed consensus here, but a Democratic-Republican consensus, because I think there has been a lessening of tensions on this important issue. We heard from Larry Summers earlier in the week, and to put it bluntly, he said well, we would get a gold medal if we got economic stimulus to hit the streets by March or April. We would get a silver medal if it were June or July. And maybe no medal at all if it was next September. You seem to have indicated in your testimony that we might have 12 months to work within. Do you think in general the quicker the better as long as it is well designed, or do we have 6 months or more to actually get the money working on the streets of America?

Mr. BERNANKE. The 12 months, Congressman, the 12 months I was referring to is the amount of time over which the spending effects would be felt.

Mr. COOPER. Okay.

Mr. BERNANKE. I think in order for this to be effective, you need to move very quickly. There are some constraints in terms of how quickly—for example, if you have rebates to consumers, there are some technical issues about how quickly the IRS could gear up to do that. You know, it could be as much as a couple of months depending on how much resources are put into it. But I think in order for this to be useful, you would need to act quite quickly.

Mr. COOPER. Promptly. And that will necessitate some sort of a bipartisan agreement so that we can move this very quickly. Fortunately, the AMT relief was given last year, so between now and April 15th taxes will not be going up. And that is $52 billion of help for some 27 million Americans. And that is good. On the design of the package, that is the key question. And you were talking earlier to Mr. Garrett, saying that this could be accommodated within PAYGO. Because PAYGO only says that things have to be paid for sometime within the next 5 years. And that gives us until 2013 to pay for this. And my preference would be to pay for things through spending cuts. There are other ways to pay for things. But I am very much hopeful that this well-designed package can be in fact paid for, because exactly as you say in your testimony, we should do nothing to exacerbate the longer-term financial problems, the structural deficit problems that our Nation faces.

So I think that is going to be the key challenge for policymakers today to go ahead and have the short-term fiscal stimulus, but to make sure not only that we do no harm in the long-term future, but that we actually try to improve the long-term outlook. Because I was very disturbed last week when Moody's joined Standard and Poor's, who had indicated a year earlier projecting that the U.S. Treasury bond might lose its AAA credit rating in about 10 years. And that seems like a long time away, but when you are dealing with 5- and 10-year horizons, that is probably within reach of the term of the next President of the United States. So long-term situations cannot be ignored as we debate this short-term fiscal stimulus.

So I welcome your testimony, and I appreciate your guidance for this Congress. Thank you.

Chairman SPRATT. Mr. Hensarling of Texas.

Mr. HENSARLING. Thank you, Mr. Chairman. Welcome, Chairman Bernanke. In looking at recent economic history, when I looked at the recession that we were facing in '01, and I look at the rebates that were given, I believe that in many cases they were important.

But Chairman, as I look at those rebates, my reading of history is that although consumer spending temporarily increased, that capital investment spending perhaps decreased by roughly the same amount, and that after that package was passed, that the economy did not overall improve. It wasn't until '03 that you had the lowering of marginal rates and the significant cap gains tax relief and dividends relief that you really stimulated the economy that has led to the longest period I think of uninterrupted job growth perhaps in our Nation's history. And certainly one of the most robust periods of economic growth. And I see a similar phenomena in the 1981 package, where again marginal rates were lowered. And so although it may be important, some type of rebate package, since we all know that we have constituents who are struggling to pay their healthcare premiums, send a child to college, keep a roof over their head, I am not sure that rebates equate to long-term economic stimulus.

And so one, my question is what is your reading of the history of the '01 and '03 tax relief packages? And when we talk about stimulus, is it more important to stimulate temporary consumer demand, or is it more important to stimulate long-term sustainable job growth?

Mr. BERNANKE. Congressman, on the history—and let me just reiterate what I said before, which is that economics is not that precise a science. So there is plenty of room for disagreement about how big these effects have been.

My judgment and I think the judgment of most of the empirical analyses that have been done was that the rebates in 2001 did have some impact on spending and that that was of some assistance in keeping the 2001 recession relatively moderate.

It is true that capital spending was quite weak. Indeed, the 2001 recession was in some sense a business-led or investment-led recession, and the interpretation that most economists gave of that fact was that following a huge amount of investment during the stock market run-up in the late 1990s, that there was a capital overhang

and that businesses didn't see much reason to invest. And so they pulled back their investment quite significantly.

In 2003, tax policy again, I believe, did help stimulate the economy. Monetary policy also was quite stimulative in 2003. And those things helped the economy recover, as well as its natural recuperative powers. So again I think there were a number of factors at work.

In no way do I want to express lack of concern with the critical, long-run issues of achieving an efficient, fair, simple Tax Code and of achieving a well-balanced and fiscally responsible government budget. I think those are critical elements; and I hope and expect that this Congress over the next—this session and the subsequent sessions will be looking very closely at these important issues. They are critical issues, and in terms of our long run health, they are clearly quite important.

The topic that we are discussing today, though, is the very near term and the risk of a significant slowdown associated with the housing bust and with problems in financial markets and the like. And the question has been raised to me and others whether or not some kind of temporary stimulus might be helpful in avoiding a slowdown or a more significant slowdown, and that is what I am addressing today. And I think——

Mr. HENSARLING. Chairman Bernanke, in that regard, on page 3 of your testimony you say that outside the United States economic activity in our major trading partners has continued to expand vigorously.

As I look at the EU and other industrialized nations, I see that over the course of the last few years, many of these nations have slashed their corporate tax rates, and I think, with the exception of Japan, we have the highest business tax rate of any industrialized nation in the world. And so, as we see their economies expand vis-a-vis our own, is there a lesson to be learned from that, particularly juxtaposed against the threatened tax increases we have seen in this Congress, including the one announced by the chairman of the Ways and Means Committee, his alternative minimum tax plan that could increase taxes for 90 percent of Americans at 3.5 trillion in tax increases over 10 years?

So the question is, is there something to be learned about expanding economies that are lowering their business tax rates? Is there something to be learned about tax certainty so that businesses know, long term, they won't be socked with these long tax increases; and what is that connection to long-term economic job growth?

Mr. BERNANKE. Well, first, we are in different stages of the business cycle. Over the last 5 or 10 years, the U.S. compares very well with other countries in terms of its long-term growth and productivity growth, so we have a strong economy, resilient economy.

We rely on the market system. We do try to keep taxes low. I think all those things are important. And I again am in no way taking one side or the other in terms of these issues of fiscal stability and an efficient tax system. I think they are very, very important, and I hope that Congress will continue to work on trying to improve our tax competitiveness and our fiscal stability and our fiscal strength.

But again, in terms of the very near-term cyclical factors, I think that those things that you are talking about are important, but they are more about the long-term growth rate of the economy and not about the next 6 months.

Chairman SPRATT. Ms. Kaptur.

Ms. KAPTUR. Thank you.

Welcome, Mr. Chairman. I can't see you, but I know you are there. I thought I might begin with a brief perspective, having been here over two decades now, and then ask a series of four questions that can be answered very briefly or for the record.

In the last two decades, what I have witnessed here in the housing finance sector as a result of legislation passed by this Congress is a great power shift in housing finance and a great responsibility shift. And that power shift has been from local communities and local community banks to financial centers very far from where my constituents live. We have seen local banking institutions eliminated. Our thrifts, which used to promote savings and provide housing finance no longer exist.

Wall Street was empowered, and we have gone as an economy from a prosavings to a prodebt consumer credit, credit card—I think delinquencies are at all-time highs. We have changed the whole way we thought about savings and investment, including in the most important sector that any family holds savings and that is in their home.

The theory back when all of this happened, which I fought against and didn't win, was that we would never have to worry again about housing crunches leading this Nation into recession because securitization was going to save us; and it was offered as a cure-all to prevent recession. The old mantra of, well, the local community banker who looked at character, collateral and collectability, as well as community responsibility was gone; and we have moved into an era now, a very—cursory credit evaluations, very risky subprime and accounting practices and securitization.

So the whole system was turned inside out. Local portfolio lending was replaced by international securitization. Many communities like those I represent became derivative. They basically had no local institutions left but for some credit unions and some small rural banks, and all that power shifted to the megabanks and investment houses.

Here are my questions. Number one, what firms on Wall Street and which financial regulatory agencies here in the Nation's Capital are most responsible for the securitization of subprimes into the international market? Number one, which firms and which regulatory agencies are most responsible for the creation of those practices?

Number two, in order to pay for this fiscal stimulus that we are talking about here, should the bankers, financiers and board members of those institutions who brought us to this subprime debacle and were hugely rewarded while obviously failing to do even the most minimal due diligence, be required to pay back their salaries and bonuses to the people of the United States?

Number three, seeing as how you were the former CEO of Goldman Sachs, what percentage——

Mr. BERNANKE. No. You are confusing me with the Treasury Secretary.

Ms. KAPTUR. I have got the wrong firm? Paulson. Oh, okay. Where were you, sir?

Mr. BERNANKE. I was the CEO of the Princeton Economics Department.

Ms. KAPTUR. Oh, Princeton. Oh, all right. Sorry. Sorry. I got you confused with the other one. I am sorry. Well, I am glad you clarified that for the record.

What percentage level of investment in a bank or investment house do you consider to constitute effective control—10, 20, 30, 50 percent?

And finally, as we consider this fiscal stimulus package, how can we design it, structure it, to create the greatest wealth creation in our country and prevent the draining off of those precious dollars toward hollow expenditures by consumers or by the Government of the United States? How can we create wealth creation with whatever small portion we are able to direct towards investment in this country? Thank you.

Mr. BERNANKE. Congresswoman, that is quite a list of questions.

You are quite correct that there has been a major shift in mortgage lending from what is called portfolio lending, banks who lend from their own portfolio, including community banks, to a securitization model. By the way, I think the important institution that was involved in that was Fannie Mae, which essentially created the securitization market for mortgages. That was used very positive, I still think it is basically positive because it makes the mortgage market less dependent on flows of deposits into particular banks or thrifts. There were periods in the past when, for whatever reason, deposits flowed out of local banks and thrifts, and that made mortgage credit more difficult to obtain; and so the idea that there would be essentially direct access to capital markets was viewed as an important step in terms of freeing up the housing market and housing market finance.

Now, as we have learned and you correctly point out, the securitization model is not without its problems, and we have seen some of them, the so-called originate-to-distribute model, which is what we have been seeing. In particular, the question arises when you have one firm making the loan and another investor holding the loan, does the firm that makes the loan have appropriate incentives to make sure it is a good loan—a well-underwritten loan.

If you are making the loan for your own portfolio, you have a strong incentive to do so. If you are making it just to sell it off, you may have much less incentive; and that clearly has been part of the problem that we saw in the subprime situation, going back.

Ms. KAPTUR. Sir, could I ask you, does Freddie Mac have as much responsibility as Fannie Mae in the change in that securitization——

Mr. BERNANKE. Freddie came later, but it has played, also, an important role. That is essentially what those two firms do: They buy mortgages from banks and other lenders and they sell them on the secondary market. They securitize essentially. So as we go forward, I think we are going to have to look very carefully at that originates-to-distribute model, make sure that incentives are prop-

erly aligned and make sure that transparency is adequate so that people know—investors know what they are buying.

I do want to indicate and take note of the fact that the Federal Reserve has recently put out for comment an extensive set of rules and regulations that would apply to all lenders of the United States that would try to prohibit some of the practices and underwriting practices that contributed to some of these problems. But I do think that there is a major set of issues here that we have to look at going forward.

I am not going to comment on the CEO question. I don't think that is really my department.

Ms. KAPTUR. But do you think that they might have responsibility? Do they have some responsibility?

Mr. BERNANKE. Well, some of them have been fired. Some of them have lost money. Certainly their firms have taken significant write-downs.

So again, as I said before, it is hardly the case that these firms are protected from the consequences of what they have done. And it is not our intention either as a central bank or as a regulator to protect those who made mistakes from the consequence of those mistakes.

Chairman SPRATT. Mr. Chairman, Ms. Kaptur, we have got to move on because he has to leave here at 12:30. So we have got to move ahead with the——

Ms. KAPTUR. Could I just ask the Chairman, what percentage level of investment and banker investment house would the Chairman consider effective control—10, 20, 30, 50?

Mr. BERNANKE. It depends very much on the governing structure, how many directors and what role the investor plays in the management of the firm. If you are thinking of the recent capital investments by a number of foreign wealth funds, for example, those have been relatively small and they have, in general, not involved any control rights in the firm.

Ms. KAPTUR. And finally, how can we target fiscal stimulus?

Chairman SPRATT. Whoa, whoa. We have got to move on, Ms. Kaptur.

Mr. Campbell of California.

Mr. CAMPBELL. Thank you, Chairman Spratt and Chairman Bernanke.

Yesterday we saw that inflation was up and growth has been declining. If those two trends were to continue, we would head towards a classic stagflation scenario which, as Mr. Ryan alluded to, is not something we have seen since Jimmy Carter was President or something we have had to deal with.

How do you deal with inflation when we have declining growth and encourage growth while dealing with this inflation, particularly if the inflation, as it appears to be, is driven by international commodity prices?

Or conversely, how do you—through monetary policy or we through fiscal policy—encourage growth while not igniting this inflation and heading us towards a stagflation scenario?

Mr. BERNANKE. Well, you put your finger on a very difficult problem. We have two objectives and one instrument, and we need to balance those risks appropriately.

It is our sense that—as I said before, that inflation expectations are reasonably well anchored. We are looking at forecasts made in futures markets of oil and other foods and other commodities. And so our sense—and again, monetary policy has to look forward because it works only with a lag, and therefore our forecast is critical to our policy action.

Our anticipation is that both headline and core inflation will moderate over the next year or two to a level which we view as consistent with price stability.

Having said that, we recognize that the futures markets—and accordingly, therefore, the Federal Reserve—has consistently underestimated the amount of increase in the oil prices, for example, and that our ability to be effective in addressing growth shortfalls is critically dependent on our maintaining our credibility for keeping inflation low; and so in no way are we going to ignore that issue.

We are going to have to make sure that inflation remains controlled and that our credibility for keeping inflation in medium term at levels consistent with price stability is not impaired.

But you are absolutely right that the last few months have been very challenging because we have had on the one hand growth issues; we have had inflation issues and we have had financial market turmoil as well. And so we have had to balance off a number of different risks as we try to choose the right set of policies, going forward.

Mr. CAMPBELL. I will fire two more questions at you and that way I won't—make sure I won't run out of time.

The first is, you have done a lot of monetary policy—you have done a lot at the window. You have lowered rates and you obviously can lower rates some more. Other than that, lowering rates some more, are there any tools left in your monetary bag, if you will, relative—clubs left in that bag relative to this economic growth side?

And the second question is somewhat unrelated. But as relative to this potential fiscal stimulus package, wouldn't some kind of business tax-related stimulus have more of a multiplier effect on the economy? I mean, in the end, if you give someone a few hundred dollars, that helps, but if you give someone more confidence that there is going to be a job or that jobs will increase because there is business activity—and there is a lot of money sitting on the sidelines now not knowing where to go; if there are some things that encourage that money to come off the sidelines, wouldn't that create a greater multiplier effect in providing stimulus over time?

Mr. BERNANKE. In your first question, Congressman, we are focused right now on liquidity provision and other measures to try and help the markets work better, and our monetary policy. And I think for now those are really our two main tools, and we are going to continue to apply those to try to meet our objectives.

On business tax relief, again a lot depends on the structure. With respect to short-term business tax relief, should you choose to do that, the experience has been that temporary measures like temporary partial expensing, for example, or bonus depreciation, whereas it is not particularly helpful in the very long run because it is only temporary.

The fact that it is temporary may induce firms to bring up spending they might otherwise have done into the current period and therefore add to spending in the economy. And it has the advantage that to the extent they do that, you also create more capital in the economy which supports job creation. So that is an alternative direction.

And again, as I said before, what the Congress might well want to consider is a diversified mix of elements as you try to craft a package.

Chairman SPRATT. Mr. Becerra.

Mr. BECERRA. Mr. Chairman, thank you very much for joining us. I want to thank you for your thoughtful testimony.

Legislating, like economics, is a very imprecise science, and some would say I am being generous even in that description. So let me ask you to do me a favor. I am going to give you one last chance to retract your statements that you made today. And just to be sure you are clear, I am going to look at your testimony and see if you still want to stand by these statements:

To be useful, a fiscal stimulus package should be implemented quickly and structured so that its effects on aggregate spending are felt as much as possible within the next 12 months or so. Are you okay with that?

Mr. BERNANKE. I am fine.

Mr. BECERRA. Fiscal measures that involve long lead times or result in additional economic activity only over a protracted period, whatever their intrinsic merits might be, will not provide stimulus when it is most needed.

Mr. BERNANKE. Of course I support that—I believe that—and I want to emphasize intrinsic merits. I have tried to make some distinction between long-term ventures and short-term stimulus.

Mr. BECERRA. That, I understand. And you have tried to explain that a little, and I am not going to get too much into that. I just want to make sure you are going to stand by these statements, because obviously a lot of folks will cover what you say today.

You also want to say any program should be explicitly temporary?

Mr. BERNANKE. Correct.

Mr. BECERRA. A fiscal program that increased the structural budget deficit would only make confronting those challenges—the challenges of the aging population, rising health care costs and other factors—more difficult.

Mr. BERNANKE. I agree.

Mr. BECERRA. You agree. Those are your statements.

Finally, a fiscal initiative at this juncture could prove quite counterproductive if, for example, it provided economic stimulus at the wrong time or compromised fiscal discipline in the longer term.

Mr. BERNANKE. Correct.

Mr. BECERRA. Can you give me a quick definition of “longer term”?

Mr. BERNANKE. Well, you know, it is very difficult to forecast where the economy is going to be way down the road.

Mr. BECERRA. Let me make it easier for you. Less than or more than a year?

Mr. BERNANKE. More than a year.

Mr. BECERRA. Okay. That is plenty fine.

Now, let me ask you this. In your testimony and in your responses to comments, you talk about the possibility of monetary policy being complemented by some prudent fiscal policy, fiscal policy that pursuant to your statements gets the money into the hands of those who will spend it wisely, consume it wisely, quickly?

Mr. BERNANKE. That is right.

Mr. BECERRA. That doesn't mean only a reduction in someone's taxes through a tax rebate, but it could also be something that puts money in your hand to buy food today or to keep your ability to buy your clothes even if you might be on the verge of losing your unemployment insurance benefits?

Mr. BERNANKE. There are a range of possible ways to give money.

Mr. BECERRA. And so that could include food stamps for those who are trying to figure out a way how to buy the next meal for the family or how to make sure that you can buy the clothes your child needs to go back to school, if you are about to lose your unemployment benefits because you were a victim of this latest downturn?

Mr. BERNANKE. Those are all possibilities, but they differ in details; and it is up to Congress to put it together.

Mr. BECERRA. Possibilities, not necessarily what you do, but possibilities. Thank you. I want to just broach for a second—it seems to me that we now have to tell the American people that that is it. Did you see it? Because we just passed the best of times of this economic boom that we were experiencing over these last few years. We saw the best of times, I think most would agree; and I think your comments would also concur with this, that we are now probably going to see some worse times.

And so, if that is it, it is hard to believe that during the best of times we saw the rate of poverty actually—the number of people in poverty in this country actually go up. We saw the number of people in this country increase by millions in being uninsured for health, and that was during the best of times.

And so as we talk about what we do—and as you said, we should do something that is temporary and timely, and it seems targeted—I have a figure from the Congressional Budget Office that shows that the Bush tax cuts of 2001 and 2003—between the year 2001 to the year 2017—so over the course of about 16, 17 years—will have cost the American public and taxpayers about $3.4 trillion. How much we have gotten from them, that is to be measured, but I think most economists agree that most tax cuts don't pay for themselves. And if we were to extend those tax cuts and make them permanently over that same course of 16 or 17 years to the year about 2017, it would cost the American taxpayer about $7.2 trillion.

So given what you are saying, we have to have temporary, timely and targeted tax cuts—I am not going to ask you to respond if enacting or extending permanently the Bush tax cuts would be wise policy, but I would just ask you, do you disagree much with the CBO's figures on how much the tax cuts have cost to date?

Mr. BERNANKE. I agree that tax cuts generally do not pay for themselves.

But the real question is to balance the efficiency or growth benefits of lower taxes against the need to cut spending if you have lower taxes. So again, it is the law of arithmetic. Low taxes are a good thing generally, but you have to be willing to make the spending cuts to go along with it.

Mr. BECERRA. I find myself concurring with you.

Chairman SPRATT. Mr. Lungren.

Mr. LUNGREN. Thank you, Mr. Chairman.

And thank you, Mr. Bernanke, for your testimony. I am a lawyer; I am not an economist. The only thing more imprecise than an economist are noneconomists trying to talk economy.

I have to come here to be educated to understand that when the government doesn't tax me as much, it costs me? My God, the tax cuts cost the American people. I hope the average American understands that if we allow you to keep money in your pocket, we have cost you money.

That is what I just heard, and I had to come here after 4 years of college and 3 years of law school and practicing law to learn that. It is a novel idea.

Mr. Chairman, I tuned in television this morning, and I heard the same litany of the terrible news of the economy. I am not a Pollyanna. There is bad news out there. But when I hear this drumbeat every single day, every single day, and you deal with the psychology of the American people and the expectations of inflation or the expectations of the economy and therefore confidence, that has to have an impact.

And so a lot of people are tuning in to watch you today to ask you, What is the state of the economy? And as I read your testimony, you have pointed out the difficulties that we are under right now and that we will see for the foreseeable short term. But I thought I heard you say the underlying strengths of the economy remain in terms of productivity, in terms of our advances in technology, in terms of our unemployment rate at the present time—even though it has gone up, the basic employment status. And I wonder if you would talk a little bit about that, because I think the American people need to hear a little bit about the broader picture as we look at the serious issues that are there.

What are the underlying strengths that the American people ought to understand so that we don't accelerate our emphasis on the negative such that the American people don't fully appreciate the full picture?

Mr. BERNANKE. Congressman, I agree with you. I think we have some short-term issues associated with our dynamics of our housing market and some of these issues in financial markets, and so we are looking at a slowdown.

But over longer periods of time, the U.S. economy has shown remarkable and consistent growth. Particularly in the last decade or so, productivity growth has been outstripping other industrial countries quite consistently. We have a very diverse and flexible workforce. We have a highly productive economy, strong technology, many factors that are encouraging.

I think, over the longer term, that the economy will perform quite well; I think we have challenges as well. Obviously, we need to address some of these fiscal issues. We need to address our edu-

cation system. There are issues about health care. Those are all very important.

But the U.S. economy for the last—indeed, for more than a century, has shown its tremendous resilience and ability to grow despite all kinds of challenges. So in no way do I want to detract from that. And, indeed, it is interesting that as people express pessimism about the economy and so on, they often say that their own personal situation looks okay or they are more optimistic about their own personal situation.

So I am not here at all to be saying negative things about the long-term potential of the U.S. Economy. I think it is excellent. I think we have important challenges. But every economy goes through ups and downs, and right now we are in a slow period. And the question is, what policy actions might be helpful.

Mr. LUNGREN. And one of the things I am most concerned about is the long-term economic growth of this country, because it is not only important to us now, it is important to our children and our grandchildren. And if you look at the overall trends over the last decade in terms of inflation, you see that we are actually in pretty good shape, comparatively speaking—unemployment rates and so forth—and I will probably end up voting for some stimulus package.

But I think we ought to be honest. A stimulus package is an economic vitamin B-12 shot. It is going to make you feel a little bit better for a short period of time. But in terms of the true impact on the overall health of the economy, it is not that significant, is it?

Mr. BERNANKE. Well, I think we would all prefer to have steady growth over the next year rather than, you know, growth that is too slow, and that it would have an impact on people who are looking for work, will have impacts on family incomes. So the Federal Reserve is mandated to try and support maximum sustainable employment growth, and we want to do that. So to the extent that we can prevent the economy from slowing unduly, even over a relatively short period, I see benefit in doing that.

But as I have indicated, in some sense the critical issues are the long-term issues in terms of our market system, our education, our Tax Code, our technology, all the things that contribute to long-term growth. That said, I don't think we should ignore the short-term issues, and certainly the Federal Reserve is very focused on them.

Chairman SPRATT. Thank you, Mr. Lungren.

Mr. McGovern of Massachusetts.

Mr. MCGOVERN. Thank you, Mr. Chairman.

Thank you, Chairman, for being here. I think we all get it, that we need to enact a targeted, timely and temporary stimulus package and we need to act sooner rather than later. And I think it is also clear that we need to enact a stimulus package that adds up to more than just helping the rich get richer, that we need to have a more broad-based approach to providing relief to people across the country.

And experts across the political ideological spectrum seem to be coming to consensus that we need to develop a plan that also helps the most vulnerable people and households and that allows cur-

rency to flow. Many of these experts believe strongly that any stimulus plan should include a temporary increase in food stamp benefits. And I know my colleague from California, Mr. Becerra, kind of raised that issue.

My colleagues on this committee have heard me talk about rising hunger and the moral need to ensure that nobody in this country is without food or without adequate food. And I understand that to kind of deal with that challenge, it requires a long-term strategy.

And today we are focused on talking about the best way to jump-start our economy. It seems clear to me that an increase in food stamps not only should be part of any economic stimulus package, but really needs to be. Increasing food stamp benefits for the current recipients can be done quickly and, particularly now with electronic benefit transactions, very efficiently.

Fraud is not an issue today like it was under the old food stamp program. The money goes to people who have trouble with their food and other bills, and more importantly, these people will spend this money and these funds go directly into the economy.

Based on USDA research, we know that every food stamp dollar generates nearly twice that in economic activity, and according to the CBO, and I quote, "The vast majority of food stamp benefits are spent extremely rapidly, and because food stamp recipients have low income and few assets, most of any additional benefits would probably be spent quickly," end quote.

Administrative costs of such an increase are negligible, meaning that the majority of the stimulus would go directly into the economy. Currently, over half of all benefits go to the 39 percent of food stamp households whose income was less than or equal to half the poverty line.

During fiscal year 2006, approximately 27 million people received food stamp benefits. Each month nearly all benefits went to 87 percent of food stamp households that were in poverty. And according to the Center on Budget and Policy Priorities, many low-income consumers do not receive unemployment insurance and are not tax filers, and thus would receive no help from extended unemployment insurance benefits or a tax rebate. So a food stamp increase would reach a significant portion of this group.

And I have read quotes from former Treasury Secretary Larry Summers and Martin Feldstein, a former economic adviser to President Reagan. All kind of seem to agree that this would be a major help in terms of stimulus.

So my questions are—I mean, do you agree with these assessments? Does this fit into the categories that you are talking about in terms of what would constitute real stimulus? What role do you see the food stamp program playing in any economic stimulus package? And in your opinion, what would be the effect of including in the stimulus package a temporary increase in the food stamp program?

Mr. BERNANKE. Congressman, I don't want to usurp Congress' prerogative in terms of figuring out the best ways to get money——

Mr. MCGOVERN. That is okay. You can do that if you want.

Mr. BERNANKE [continuing]. So I think what I will say is, I think there is good evidence that cash that goes to low- and moderate-income people is more likely to be spent in the near term. And so

I think that logic carries through. But the exact way that you deliver—if you decide to do that, the exact way you deliver an exact mix, I think is up to you.

I guess I would also comment that food stamps and some of these other things are relatively small compared to the overall size of a package, and so it certainly could not be the—if you were doing that, it couldn't be the only mechanism.

Mr. MCGOVERN. No. And I appreciate that.

But again, listening to what you were saying here today about what could constitute an important stimulus, getting benefits to people quickly, we know that we saw how—how we were able to do that in Hurricane Katrina; and there was a big snowstorm in Buffalo, New York, and we were able to respond with food stamps quickly, you know, knowing that this generates more economic activity.

I am not saying this should be the only thing in the stimulus package, but clearly it seems to me that it should be an important thing. And I wanted to make sure it fit into what you were talking about in kind of general categories of what would help the economy move forward.

Mr. BERNANKE. Getting money to people quickly is good. And getting money to low- and moderate-income people is good in the sense of getting bang for buck.

Mr. MCGOVERN. Thank you.

Chairman SPRATT. Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman.

And, Chairman Bernanke, thank you for being with us this morning. One quick technical thing. You mentioned in the testimony a "term auction facility." Does the Fed guarantee that principle? What is the attraction there for banks to go to that window and buy that—swap those dollars with each other?

Mr. BERNANKE. We have collateral. The banks put collateral at our window, at our discount window, and they borrow against that collateral. And since that makes the loan safe for us, we can afford to——

Mr. CONAWAY. Less the discount rate, what the TAF——

Mr. BERNANKE. The TAF is essentially the discount window, except delivered through an auction format rather than through a direct loan format.

Mr. CONAWAY. Thanks.

Some of this issue has been created by folks borrowing money they can't pay back, whether it is on housing or credit cards or whatever it is. Much of your testimony focused on helping provide more credit, extending more credit.

Is there evidence, either empirically or anecdotally, where qualified borrowers are, in fact, unable to borrow money and that we can continue to debt our way out of this issue? Am I misunderstanding that?

Mr. BERNANKE. First of all, the fiscal proposals don't involve anyone increasing their debt. It would just involve either tax rebates or some other——

Mr. CONAWAY. But your monetary side, where——

Mr. BERNANKE. Yes. So I think it is a concern if banks—you want banks to make sound loans. You want them to do good under-

writing. But if banks get to a position where they simply decline to take on new customers, for example, or they are extraordinarily tight in their standards because they are afraid of using up their available capital, then that can be a restraint on the economy. We want to have a balance.

Mr. CONAWAY. I understand that. But we want to make sure the medicine is for the right disease. And do we have a credit issue with respect to banks, in general, being unable to lend to good, qualified customers that you want, underwriting standards, the character that Ms. Kaptur was talking about, the local guy knows? Are we at that point?

Mr. BERNANKE. The biggest problems right now are in mortgage markets where terms and conditions have tightened considerably and banks are relatively reluctant, for example, to make good, jumbo, prime loans. They charge a significant premium for those.

For low- and moderate-income people, there is such a thing as good subprime lending. It has been done responsibly and can be done responsibly, but essentially, at this point, there is none being done at all because they know they can't securitize it. So particularly in the mortgage market, but to some extent in other markets we are seeing some tightening of credit conditions.

I agree with you that you want to have good, strong underwriting and make sure it is the best borrowers who get loans. But we just don't want to have banks sort of overshooting, so to speak, and making it difficult even for qualified borrowers to get loans.

Mr. CONAWAY. But that is something you would watch for, qualified borrowers unable to get—I spent a brief bit of time in my career in banking and loaning money to people who pay you back was the idea, and not loaning to folks who hadn't paid other folks back was generally a red flag to not do that kind of stuff.

Back on the tax side and certainty of our Tax Code, whatever it might or might not be, you mentioned that business incentives, higher depreciation, bonus depreciation, are the kinds of things that immediately would accelerate that. Can we also infer from that that future tax increases either threatened or in the Code now would lead businesses to delay investment into those periods where their tax rates go higher?

Mr. BERNANKE. There is a theoretical possibility there that if——

Mr. CONAWAY. If next year's tax rate is going to be higher and I have got to build something or buy something, wouldn't it be to my advantage to delay that purchase into a period where the tax depreciation rules are more favorable or the rate is higher, and that makes the depreciation I am going to get more valuable to me?

Mr. BERNANKE. I think your point in principle is certainly correct. I am not sure that—are you contemplating raising——

Mr. CONAWAY. I am not, but everybody else on the other side is.

Mr. BERNANKE. I see. In terms of trying to stimulate near-term capital spending, I think the general view is that using taxes that apply—tax provisions that apply directly to capital formation, such as depreciation or investment tax credits, have a bigger bang for the buck than do just general corporate tax rates.

So if you are going to do that, if you are going to try to make investment spending part of this package, then temporary meas-

ures that provide incentive to firms to bring up their—increase their capital spending are probably the most effective.

Mr. CONAWAY. Thank you, Mr. Chairman.

Thank you, Mr. Spratt.

Chairman SPRATT. Mr. Andrews.

Mr. ANDREWS. Thank you, Mr. Chairman.

Thank you, Chairman Bernanke. I think you have done the country a really good service by your laying out of the problem and some principles to help us solve it. You have obviously learned well from your time on the Montgomery Township, New Jersey, Board of Education. We appreciate that.

There are three ideas on the table for short-term stimulus that we have heard members talk about. One is accelerating some business tax reduction, whether it is expensing or what have you. The second is direct consumer tax rebates. The third is some expansion of programs, such as food stamps.

Are there any data that suggest that among those three there is one that is better than the others in terms of multiplier effect, in terms of effectiveness?

Mr. BERNANKE. Well, there are multiple considerations. I think just in terms of the effect on—for each dollar spent on spending, the highest multipliers are probably from tax rebates or other payments to low- or moderate-income people, who are likely to spend quickly.

The immediate impact through, for example, accelerated depreciation is more disputatious. There are different views on that. But there are other considerations, such as the fact that you create more capital and that is beneficial.

So none of these things depends only on the multiplier. But I think most packages we have seen in the past have included at least some component of tax rebates to low- and moderate-income people.

Mr. ANDREWS. Given the fact that that is a desirable option, are there data on efficiency levels of spending by quartile of income group? In other words, do the people at the bottom quarter spend more of that rebate more quickly than people at the top?

Mr. BERNANKE. There are some studies which suggest—and again, I really need to emphasize the uncertainty associated with econometric estimates and so on, but the studies do suggest that people of lower incomes or those who are “liquidity constrained,” which means they find it difficult to borrow for one reason or another, are more likely to spend in the near term than people, for example, that have extensive assets to draw on and therefore don’t need to adjust their spending to their income.

Mr. ANDREWS. I think I heard you say there are some pretty solid data that tax rebates to consumers are an effective stimulus, given the way we are defining effectiveness in this discussion; and second, that tax rebates that, I won’t say disproportionately, but at least to a fair share go to the people at the bottom ladder are also quite effective in achieving that short-term bump that we are looking for; is that correct?

Mr. BERNANKE. In terms of stimulus, because people who are of low income or have few assets or find it difficult to borrow are more

likely to spend the money in the near term? That has that benefit from the stimulus point of view.

Mr. ANDREWS. One of the things that is striking about your testimony is this balance that we have to find between the short-term needs that we have and avoiding long-term harm. It is sort of like steroids, that you want to address an infection quickly, but you don't want to create an adverse impact.

I guess this is a timely week to be raising that issue around here.

Chairman SPRATT. On that note, I think we had better move on, Mr. Andrews.

Mr. ANDREWS. Yes, Commissioner.

The question, if I can just quickly ask, is there a way that we could do some short-term stimulus that actually helps to solve one of our structural long-term problems? For example, energy, is there any argument for the proposition that there should be a steeper subsidy or a larger rebate if what is purchased is something that uses renewable fuels, for example? In other words, would we want to have a policy that encourages the purchase of automobiles that are more efficient vis-a-vis other——

Chairman SPRATT. Mr. Andrews, let's get the answer to that question, and then we will move on.

Dr. Bernanke.

Mr. BERNANKE. As I said in my testimony, there are many intrinsically interesting or useful things that may not be part of a stimulus package. And the issue you need to address there is how quickly would spending take place and what would be the marginal amount of spending that such a program would produce.

Mr. ANDREWS. Thank you.

Chairman SPRATT. Mr. Barrett of South Carolina.

Mr. BARRETT. Thank you, Chairman Spratt.

Chairman, great to see you. Here I am. We are jumping around over here. Thank you for being here today.

Reading your testimony, quote, "economic stimulus at the wrong time or compromised fiscal discipline in the longer term"—and you are talking about a stimulus package, fiscal initiatives and stuff like that. Fiscal discipline in the longer term is what I want to concentrate on, Chairman. And this is not a Republican problem, this is not a Democrat problem, because I can tell you when we were in charge, we did it too. We are doing it now.

Does the Congress spend too much money, Mr. Chairman?

Mr. BERNANKE. That is not my call. My call is to say that—government spending——

Mr. BARRETT. It is a nonpartisan question, Mr. Chairman.

Mr. BERNANKE. No, it is not a nonpartisan question. There are value judgements there.

If you spend on a certain kind of program, you have got to make a judgment: Is it—is the value of this to society worth the extra taxes you need to pay for it? And that is something that only the elected leaders of our country can represent the people's views on. That is not a value-neutral question.

My concern is that we have, I think, a pro-growth Tax Code, one that is efficiently designed and fair and simple. I am also concerned

that we have budget balance in the long run. Those are the things that are important for growth.

But in terms of whether an additional program is worth the extra taxes, that is for Congress. And I really don't have——

Mr. BARRETT. I appreciate it. We need to get you back down to South Carolina a little bit more, because I can tell you in South Carolina they think we spend too much money. I think this is a nonpartisan.

What about uncertainty in our fiscal policy? If we had some sense of certainty out there in the free market, don't you think—no matter what the policy is, if there was certainty, that certainly would help in our potential growth. Would you agree with that?

Mr. BERNANKE. I think certainty is helpful, yes.

Mr. BARRETT. Good. That is a good one.

Moving right along, trying to get us out of this recession when we are thinking about a package, some people have said, okay, let's give the money back in a bulk sum, so we can give some instant stimulus; some people have said long-term tax cuts or looking at fiscal policy.

Does it make sense, Mr. Chairman—and I am—again, I am not saying one is better than the other. What I am saying is, does it make sense to look at both of them and maybe have a balance in our policy that may have a combination of both?

Mr. BERNANKE. Between spending and tax cuts?

Mr. BARRETT. Yes, sir. Like a tax credit as part of it in the short term, and in the long term having some type of long-term tax cut fiscal policy, something like that, so we could do a combination in a package. Does that make sense to look at both of those?

Mr. BERNANKE. Well, as I have indicated, I think there are some really important long-term issues which this fiscal stimulus doesn't—is not necessarily designed directly to address. And I think there is a political question about whether or not—you know, within the short period of time we are talking about, the Congress can address all these very difficult long-term issues. They have to be addressed, and if you can do so, that is terrific.

Mr. BARRETT. And I don't mean to cut you off, Chairman, because my time is short.

You know as well as I do, sometimes having the opportunity to address some of these things, you know, timing is everything. So if there would be a way we could address both of these issues in the same package, would it make sense to do that?

Mr. BERNANKE. If you can address the stimulus and at the same time make good decisions about long-term tax policy and long-term fiscal balance, that would be a terrific thing.

Mr. BARRETT. Good. Thank you.

Last question, I think is all I am going to have time for: High prices in oil coupled with the weak dollar, kind of tell me how that affects what we are doing and if there is anything we can do in the short term with the price of oil and the devaluing dollar.

Mr. BERNANKE. I don't think there is that much that can be done in the short term. The most important factors affecting oil prices are supply and demand, and we have a growing world demand for oil and for energy and for commodities, and supply is limited. So that is difficult. That is another one of the long-term issues that

Congress needs to address in terms of energy, energy efficiency and security.

For us at the Federal Reserve, high oil prices are a real bane because they create inflationary pressure at the same time that they take away spending and income and tend to depress the economy. So they make it very difficult for us.

Mr. BARRETT. The falling dollar, does it concern you, Chairman, that maybe someday we will wake up and the world will say, Hey, guess what, guys, we are not using the dollar as the world standard anymore; we are going to use something else?

Mr. BERNANKE. I always have to begin by saying that the Secretary of the Treasury is the official spokesman on the dollar.

Mr. BARRETT. I understand. I understand.

Mr. BERNANKE. My view on that is that—at the Federal Reserve is that we need to make this economy strong and have price stability. And if we do that, then in the medium term, the dollars will reflect the strength of the U.S. economy, which I have a lot of confidence in, again in the medium term, as we discussed before.

Mr. BARRETT. Good. Thank you, Chairman.

Chairman SPRATT. Mr. Allen.

Mr. ALLEN. Thank you, Mr. Chairman.

And thank you, Chairman Bernanke, for being here. I want to just follow up and say, it may seem like Economics 101, but you said that cash, whether it is tax rebates or other money going to low- and moderate-income people is more likely to be spent quickly, that is the phenomenon of the multiplier.

But could you just explain the multiplier enough to help us understand why it is true that money going to those groups is more likely to create—have a stimulative effect on the economy?

Mr. BERNANKE. Well, one of the concerns that people have right now is that the consumer is pulling back and that consumer spending is not going to grow as quickly, which would tend in the short term to depress the economy because consumption spending is about 70 percent of total spending. So the question is, can we find a way to get the consumer to be a little less hesitant to spend.

In terms of who is most likely to spend, if you are somebody who has lots of financial assets and you receive an extra dollar, you may not change your spending much because you can simply either put the dollar in your bank account or take out a dollar as you need it. If you are somebody who lives paycheck to paycheck, you are more likely to spend that extra dollar. The evidence seems to be consistent with that.

Now, I want to be clear that people at all levels of income do seem to respond to some extent to extra cash. But both sort of economic logic and the empirical work we do have suggested that effect is somewhat stronger for people with low financial assets or low and moderate income.

Mr. ALLEN. Thank you.

My state, like many others, has seen an erosion of middle-class jobs in recent years, with particular losses in the manufacturing industries. And in your testimony, you remark on recent changes in the labor market, stating that while employment in the service sector has continued to show slow growth, there were significant decreases in residential construction, manufacturing and retail trade.

And though you say we shouldn't read too much into one month's data—but it is—it sure looks as if job losses in construction, manufacturing and retail trade indicate we are losing middle-class jobs, we are losing the kinds of jobs that people could support a family with. Do you agree with that?

Mr. BERNANKE. Well, those categories contain a wide range—construction can include labor, it can include a foreman. Retail can include a salesclerk, it can include the CEO of Sears. So there is a quite a range of people who are in these different categories.

Manufacturing, you mentioned specifically. Manufacturing does tend to be cyclical. So when the economy overall slows, manufacturing tends to slow generally by more, and therefore the loss of manufacturing jobs, as we have seen recently, is partly indicative of a slowing economy.

Now, more generally—I don't want to take all of your time—but more generally, of course, we have seen a long-term downward trend in manufacturing jobs—a lot of reasons for that. One of them is simply the fact that U.S. manufacturing is so productive and has become so much more productive that even though we produce as much stuff now as we did 20 years ago, we can do it with many fewer workers, and that productivity gain reduces the number of workers that are needed.

Mr. ALLEN. Let me just conclude with this question.

As we think about different components of a stimulus package, can you comment on whether there are some components that might drive job creation more than others?

Mr. BERNANKE. Well, as I have noted, I have noted the spending propensities of lower- and moderate-income people, and I think that is one consideration. But you also have to look at all of the factors involved. For example, the business-oriented cuts create capital formation, which has additional benefits. So you need to look at a variety of factors.

And also you need to think about the fiscal implications. For example, you might be inclined to say, well, the bigger the package the better, which might be true up to a certain point in terms of near-term stimulus, but it isn't obviously the case if you are taking into account the need to offset that or at least eliminate that deficit implication going into the future.

Mr. ALLEN. I guess I will just conclude by thanking you for being one in a long line of economists who have sat there and testified that tax cuts don't pay for themselves. We have such a challenge in getting to balance, as you put it, and making sure that whatever we do right now with a stimulus package provides the maximum amount of stimulus in the short term, but doesn't increase the long-term financial condition of the United States, make it worse than it is today.

I yield back. Thank you.

Chairman SPRATT. Mr. Bonner.

Mr. BONNER. Thank you, Mr. Chairman.

Mr. Chairman, welcome. I have sat here this morning listening to you and I had the privilege of doing so with your predecessor a few years ago. And I must tell you, it is an amazing country we live in. I have a 9-year-old son and a 12-year-old daughter, and I have a very difficult time most times convincing them that what

I have to say has merit and value and that they need to listen to me. And yet as Chairman of the Board of Governors of the Federal Reserve, the world is watching, and certainly the people of this country and Wall Street and others, and we are hanging on every word you say and what color tie you wear and whether you feel good. And I think that is a statement about where we are as a country; I guess also a statement about the important role that you play in our country and as the world leader—economic leader in the world.

There has been some conversation earlier about tax cuts, and you did say that tax cuts do cost money. I think most everyone here, Republicans and Democrats, concede that point. But I guess from your perspective, do tax cuts cost the American people money or do tax cuts cost the American Government money? And to that end, in your view, which historically—as we are talking about a short-term stimulus package, which historically have been most influential in making a difference in our economy, taxpayers or government spending?

Mr. BERNANKE. Well first, let me say my children don't listen to me either. So tax cuts, I think whether they pay for themselves is not the issue. The question is whether you have well-designed taxes that promote efficiency, promote growth, promote saving, promote productive economic activity. That is very, very important. The challenge, and I hate to fall back on this law of arithmetic point again, but you know, government spending does have value, of course, and we all have programs that we think are producing good things for society, and the military, and national parks, and many other things that we want to spend money on. And the challenge is finding the right balance. How big a share of the Nation's GDP do we want to flow through the government? If we really want low taxes, and that certainly has benefits, we also have to make a judgment about what—you know, be very tough about what government programs we are willing to spend on. There is some who think that government programs can be very productive, and point to many different things. That is fine, that is the prerogative of a Congressperson to make that judgment on behalf of their constituents. But again on that side you then have to take the higher taxes that go with it.

So I am just trying to say that you need to make—it is up to you as representatives of the people to make a judgment about how big a share of the economy should be devoted to government spending. A lot does depend—it is not just a share of the economy that is controlled by the government, a lot of it depends on how well the money is used and how well the taxes are collected. If you have an efficient tax system, that will support growth. On the spending side, all else equal, you are better off if you put money into things that promote growth, like technology and education, and things of that sort. So those are all, you know, tough decisions that you have to make.

Mr. BONNER. Could you also share, just shifting gears briefly, at the beginning of this Congress the price, average national price for a gallon of gas was $2.22. Today the average national is $3.04 a gallon, an $.80 increase. Oil a year ago at this time was $45 a bar-

rel. It is today $89.60 in the United States. World price is over that. It has been over a hundred dollars a barrel.

What influence, in your view, if any, has the fact that we have not, Republicans and Democrats alike, taken a real bold step toward energy independence in this country in terms of its impact on the economic situation we find ourselves in today?

Mr. BERNANKE. Well, certainly oil and gas are still, obviously, a huge part of our energy portfolio. And people are still driving and using oil and gas despite these high prices. I guess one of the advantages of high prices is that ultimately they are going to induce people to conserve, and it is going to make it profitable for firms to come up with alternative energy sources. And I think the government should support that activity. Government can help support basic research, for example, that can help us find different ways to provide energy. The government can provide regulatory clarity and certainty so that, for example, if you want nuclear plants, can they be constructed in a safe way, but that meets regulatory scrutiny? And to some extent, you know, the government can try to encourage specific approaches. But I think, as painful as high oil prices are, and they certainly are painful and causing a lot of problems, they do have one benefit, which is that they do provide a strong incentive, both for suppliers and demanders, to find alternative sources of energy. And I hope that is going to be the case over the next 10, 15 years.

Mr. BONNER. Thank you, Mr. Chairman.

Chairman SPRATT. Thank you, Mr. Bonner.

Mr. Doggett of Texas.

Mr. DOGGETT. Thank you, Mr. Chairman, and thank you for your testimony. You know, some people spend so much time here in Washington they lose sight of what low and moderate income people means in this country. What do you mean by that term?

Mr. BERNANKE. Well, the median income in the U.S., I believe I have got this right, is about $48,000 for a family.

Mr. DOGGETT. So you are talking about people $48,000 and below in——

Mr. BERNANKE. Well, it is not a sharp cutoff. I think, again, people of lower income will tend to spend more out of these rebates. But as I said, even relatively high income people do spend some out of a rebate. And so it is more like a continuous line than a sharp——

Mr. DOGGETT. Sure. When you talk about the best multiplier effect for a stimulus being for low and moderate income people, you are really talking about, you know, $50, $55,000 and below, aren't you, in terms of the maximum multiplier effect?

Mr. BERNANKE. Again, weighting towards low or moderate income people for multiplier purposes is beneficial. I think you are going to have to think about the problem of how to distribute the money in a timely way.

Mr. DOGGETT. Sure.

Mr. BERNANKE. For example, if you—one way to do it would be to use tax filers, because we obviously have that data available and the IRS can send checks. But of course if you do only tax filers, you would be excluding some people who don't file taxes.

Mr. DOGGETT. Right.

Mr. BERNANKE. So there is some question about how the best way to get money out quickly is.

Mr. DOGGETT. And in terms of the fiscal stimulus that you feel would be desirable, given the economic conditions we have today to supplement what you are doing with monetary policy, how big a fiscal stimulus is too big in terms of a total amount of stimulus?

Mr. BERNANKE. I don't think I can—you know, the numbers that have been thrown around, between say 50 and 75 up to 150, all those things are——

Mr. DOGGETT. Within a range?

Mr. BERNANKE [continuing]. Within a range that from a macroeconomic viewpoint is, you know, reasonable. Obviously, you get more stimulus the more dollars you throw at it.

Mr. DOGGETT. But if you go overboard, and that is my concern——

Mr. BERNANKE. Right.

Mr. DOGGETT [continuing]. With all these lobby groups lining up to get their program in——

Mr. BERNANKE. I certainly hope that Congress can resist having, you know, a huge list of different things that should be kept separate, I mean may be valid, but should be kept separate from——

Mr. DOGGETT. Just in terms of a range, up to 150, 50 to 150, in a broad range like that would not be unreasonable?

Mr. BERNANKE. Those are all reasonable ranges. But again, one of the issues you are going to have to think about is the fiscal implication, and how you—if you are going to pay for it, are you going to pay for part of it and——

Mr. DOGGETT. And that is really an important part of your testimony, because the first hearing that this committee had was back on December 5th. And we had three very diverse economists, as I think you know, Dr. Feldstein, Fred Bergsten, Peter Orszag, all say that it is possible to have a significant stimulative effect from fiscal policy and still pay for it within the requirements of our PAYGO rules. And you agree with that?

Mr. BERNANKE. I do.

Mr. DOGGETT. And as far as the way we got into the problems that we have today, we would not have any need for fiscal stimulus at all today had it not been for the collapse of the home mortgage market, would we?

Mr. BERNANKE. Well, the combination of the housing cycle and subprime mortgages and the interaction between those two has been a big part of it, yes.

Mr. DOGGETT. And you believe that in addition to any fiscal stimulus steps we take we should be looking at the regulatory issues that are associated with that whole subprime debacle that got us into this problem?

Mr. BERNANKE. I do, although I would point out again that the Federal Reserve has already issued for comment an extensive set of rules addressing subprime lending, which at perhaps some other occasion I would be happy to discuss with you.

Mr. DOGGETT. And certainly it would—you conclude in your written testimony, I think quite appropriately, by expressing concern about the structural budget deficit. If we put in place significant long-term, not temporary but long-term tax cuts, you think that

would be undesirable in terms of increasing—unpaid long-term tax cuts, in increasing the structural budget deficit?

Mr. BERNANKE. Again, I think you need to look at the overall budget and, you know, make some tough decisions about the combination of taxes and spending which promote our national goals the most effectively.

Mr. DOGGETT. But I gather from your testimony when you talk about a fiscal program that increased the structural budget deficit would only make confronting the challenges more difficult, that whether it is unpaid for spending or unpaid for long-term tax cuts, the effect is the same, it increases the structural budget deficit, and you don't want either?

Mr. BERNANKE. If you want low taxes you need to find ways to keep spending low. And if you want high spending, you need to find ways to raise the revenue.

Mr. DOGGETT. Exactly. Thank you.

Chairman SPRATT. Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman. Your testimony was excellent today. And I would like to follow up on some of the comments that you have made and some of the comments that have been talked about today. I agree with everything you said with respect to short-term stimulus. A year from now when you come back and testify before us, after we get behind this issue, we are looking at the next year, 2 years, what effect does tax uncertainty going forward in the next 2 to 3 years have on taxpayers? On savers? On investors? On entrepreneurs? When they hear over and over on TV, on news shows that the tax cuts that were passed earlier this decade are going to expire, and if they are not repassed taxes will go up on a variety of different things, what does that uncertainty do for those taxpayers, investors, workers, and entrepreneurs?

Mr. BERNANKE. I am sure that uncertainty causes some problems. And I don't know how to quantify that exactly. And there are many dimensions of that. I mean, another example would be—I know you are referring to the President's tax cuts. But yet another example is the Alternative Minimum Tax——

Mr. TIBERI. Right.

Mr. BERNANKE [continuing]. Which has been patched 1 year at a time, and there has been no sort of long-term resolution of that. I think this does—I mean I think the fact that the Code keeps changing and that there is uncertainty about that does have some adverse effects. So to the extent that as part of, you know, going forward you can find a more stable, you know, long-term solution to our tax and spending priorities, that would obviously be helpful.

Mr. TIBERI. If you look at the tax cuts that are set to expire in a couple years, which would you look at as having, if they do expire, and go up, pro-growth taxes, which could do the economy most harm by going up if you look at people's behavior in terms of pro-growth economics?

Mr. BERNANKE. If you wouldn't mind, I would prefer not to get into that. Again, I would be—again, I am concerned about at this point, particularly in this discussion of fiscal stimulus, about taking a strong position on one side or another. But that is a very complicated issue. And there are a lot of factors that I could talk about, but——

Mr. TIBERI. But it does have impact on people's behavior?

Mr. BERNANKE. Certainly taxes obviously have impact on people's behavior, and I would certainly agree as a general matter that low taxes tend to stimulate efficient economic behavior and stimulate growth. And the trade-off one faces is between low taxes on the one hand and higher spending on the other.

Mr. TIBERI. Thank you. Thank you, Mr. Chairman. I will ask you that question a year from now.

Mr. BERNANKE. Okay.

Mr. TIBERI. The other avenue I wanted to head down is with respect to this housing issue that you have talked about. And you made a comment earlier. As a former realtor, I found it interesting that there was good subprime and bad subprime, which I think has been missed in the national media. Would you concur there are people in homes today, and in fact we have home ownership levels at all time highs, which also gets failed to be mentioned, that there are people in homes today who would have never been in homes in terms of their economic status 20 and 30 years ago because of the change in the way that the American marketplace has worked with respect to lending, and that there are people in homes today that have subprime loans given to them that are fine, and they are living in their homes, and they are absolutely fine, and they wouldn't be if it weren't for that loan product? And that the housing—the credit crunch and the housing slump is more complicated than just blaming it on bad, and there are bad, subprime loans?

Mr. BERNANKE. Well, I have been to many communities where I have seen, for example, cooperation between lending institutions and local community groups that have been extraordinarily effective in making subprime loans with low rates of default and high rates of home ownership. So I know from personal experience that it can be effective. If you look at the aggregate data, you will see that there has been this huge increase in delinquency rates among subprime mortgages with adjustable rates which adjust to very high levels, but if you look at subprime mortgages with fixed rates there has been some increase but they remain on the whole, reasonably stable. I don't think there is any reason why people of—you know, with less complete credit histories cannot qualify for home ownership or for a mortgage. And there is plenty of experience to show that it can be done well. Obviously, it was not done well in many cases in the last couple of years.

Mr. TIBERI. Thank you, Mr. Chairman. Thank you.

Chairman SPRATT. Mr. Moore.

Mr. MOORE OF KANSAS. Mr. Chairman, thank you for being here and for your testimony. Our country has a $9.2 trillion national debt, a debt which has increased $3 trillion over the past 7 years. I am concerned that this unprecedented increase in debt, along with the long-term fiscal challenges our country faces will hurt our country's economic future and force my eight grandchildren and other children their age and future generations in our country to bear the burden of the debts that we are incurring now. As our debt has grown, the United States has relied more on foreign investors to purchase our debt. In fact, foreign investors have doubled their holdings of U.S. debt since 2001. Today they hold a substantial portion of our public debt outstanding, which increases our

economy's vulnerability to potential political or economic instability from abroad.

Mr. Chairman, if the Federal Government continues to run consistently large deficits, and accumulates more debt, what impact could this have on economic growth in our future and in our country, and both in the short and long term? Would you agree that ongoing deficits are a serious threat to the health of our economy?

Mr. BERNANKE. I do. And I think that the $9 trillion that you cite in some sense understates the problem because it doesn't include the unfunded liabilities of——

Mr. MOORE OF KANSAS. Right. Social Security and Medicare?

Mr. BERNANKE. Social Security and Medicare, which are enormous, in fact dwarf the $9 trillion.

Mr. MOORE OF KANSAS. Yes, sir.

Mr. BERNANKE. The fundamental thing is that we are an aging society, we are the boomers who are going to be retiring, and our children are going to have to find a way to support us one way or another, through private or public means. And we need to address that problem by finding ways to, you know, maintain the long-term fiscal stability. That is a very, very tough challenge. But if we don't do that, we are going to come to a crisis at some point, because you can't grow the debt of the government indefinitely. Eventually, at some point it begins to explode in some sense, and we can't continue to finance it.

So CBO, for example, has done a number of studies, different scenarios showing how the debt would increase over the next 20, 25 years. And it is not more than two decades away before we will be reaching levels that are really unsustainable. And we need to begin, as I said in another testimony 10 years ago, if possible to try to address these issues.

Mr. MOORE OF KANSAS. Mr. Chairman, should we be concerned about foreign nations such as China, which holds almost a trillion dollars of our debt now, about their influence in our country and how—what that might portend for our country in the future? Do you have any concerns about that, or is that something you feel comfortable commenting on?

Mr. BERNANKE. Well, China holds our debt for their own economic purposes. They use it for foreign exchange reserves——

Mr. MOORE OF KANSAS. Right.

Mr. BERNANKE [continuing]. And sovereign wealth funds and the like. I don't think they have any particular incentive, for example, to see——

Mr. MOORE OF KANSAS. Sure.

Mr. BERNANKE [continuing]. The value of that debt fall sharply. So, you know, given that we are, as a country that we are investing more than we are saving, we are not saving enough——

Mr. MOORE OF KANSAS. Yes, sir.

Mr. BERNANKE [continuing]. We have to borrow from someone. And it is good that we have creditors who will extend us the credit. But obviously, as you point out, we need to move in the direction of greater balance. And what you are referring to is the trade balance——

Mr. MOORE OF KANSAS. Right.

Mr. BERNANKE [continuing]. Which is somewhat different from the government deficit. I think the good news is that there has been some tendency for improvement in the trade balance over the last couple of years. And I think that is going to continue for a while. The bad news is it is still quite large, and therefore the foreign debt, not just to the Chinese but by many other creditors as well, is continuing to accumulate.

Mr. MOORE OF KANSAS. Thank you, sir.

Chairman SPRATT. Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman, and thank you, Chairman Bernanke, for being here. I think you should be commended by Congress and the American people for your actions in August of this past year that significantly strengthened our ability to get through these challenging times in the marketplace, and so thank you for your leadership there.

There are some things you touched on in your testimony, you have touched on them in speeches you have made around the country, that the crisis we are facing, the mortgage crisis as some of the media have called it, and I want to touch on this just for a few minutes, I want to get your feedback on it.

Are there things that Congress can do actively, do you have any suggestions in broad terms, you know, I am not asking you specific policy areas, but in broad terms are there things that Congress can do that can be helpful and constructive? And I am not asking for a yes-no question, but are there thoughts that you have that you would like to offer?

Mr. BERNANKE. Well, in terms of loan modifications and workouts, I guess there are a few things. We at the Federal Reserve are working with community groups and counselors in trying to help people work with their lenders to get their loans modified. And to the extent the Federal Government wants to support those kinds of activities, that is one direction. You have the initiatives from the Treasury, the HOPE NOW initiative, which is trying to find ways to create a voluntary large-scale renegotiations and loan modifications to try to reduce some of the financial stress coming out of this situation.

Beyond those kinds of measures, one possibility that I have discussed in the past is to continue to expand and modernize the Federal Housing Administration, the FHA. Its market share has dropped to a very low level. If it had a more user-friendly front end, if it had a diverse set of products that some of them—like shared appreciation mortgages, for example, that could be useful to low- to moderate-income homeowners, then it might be possible for more people to refinance their mortgages or to obtain new mortgages through that agency. So that is one area where I hope Congress will take a look.

Mr. MCHENRY. Likewise, are there things that could have a negative effect on the liquidity in the mortgage marketplace based on congressional action? Are there negative actions that Congress could take?

Mr. BERNANKE. Well, as I mentioned, we, the Fed, have done a set of regulations which are out for comment. And what we have tried to do there is walk a fine line, strike a balance between setting up rules that will protect consumers, but will not be so puni-

tive or onerous that they will simply shut the market down. And I think as Congress considers measures it might take, assuming that you agree with me that subprime lending if done properly is a positive thing, I hope that you will think about, you know, whether the measures that are being taken are consistent with the market actually flourishing and continuing to operate in the future when we are past this particular crisis.

Mr. MCHENRY. For instance, if we changed the legal liabilities that CDOs, mortgage-backed securities have, for instance, you know, a number of different changes have been contemplated and discussed, could that have a negative effect on liquidity in the mortgage marketplace?

Mr. BERNANKE. You are talking about so-called assignee liability, which would give investors responsibility for what happens at the front end of the transaction. As I have discussed in earlier testimonies, if assignee liability is used in order to avoid this chilling effect that you are describing, there should be very tightly delineated provisions, safe harbors and the like, in those occasions where there have not been sharply drawn lines. For example, the State of Georgia had an experience. Then you may find that lenders are simply unwilling to participate in the market. And so——

Mr. MCHENRY. Likewise, if judges have been given the power to change loan terms, would that have potentially a negative effect?

Mr. BERNANKE. You are addressing now the possibility of changes in the bankruptcy laws. And that is a very, very complex question. The Federal Reserve did not take a position on the earlier round of bankruptcy legislation, and I think I am going to stay out of that this time as well. But I do recognize that there are issues on both sides of that, including the possible effect on the cost of credit in that market.

Mr. MCHENRY. So rising costs of credit in a tough economic time is sort of a fact of it. It would increase the cost of getting credit?

Chairman SPRATT. Mr. McHenry, we have got to move on.

Mr. MCHENRY. Well——

Chairman SPRATT. We will let him answer that question, and then we will move ahead.

Mr. BERNANKE. Possibly it would, but again I am not taking a position one way or another on that particular proposal since there are considerations in terms of what benefits it might have as well.

Chairman SPRATT. Mr. Etheridge. Mr. Etheridge, could you hold your questions to about 4 minutes? We will shave a minute or two.

Mr. ETHERIDGE. I will try to do that. Thank you, Mr. Chairman. And thank you for being here. And let me join the others in thanking you for your openness and being available. It is helpful. Let me ask a couple of questions very quickly. And you have touched on this, but if you have an opportunity to expand on it I would appreciate it, because I realize we got here through the subprime. But I would be interested in your comments of how much the economic downturn may have been exacerbated by the continual high prices of gasoline. Because that affects the confidence level of the consumer. You only buy a house, hopefully, in a lifetime, but you buy gas several times a week. And when you see it at $3, and especially for the people who are working every day, and I go by and purchase my gasoline as others do it in the service station, and I see

people who buy $3, $5. And at three bucks, that is just over a gallon. And people buy just enough to get to work. And then they buy enough to get home. I would be interested in how that is impacting the economy. Because if you had a drop in December of the consumer purchasing, there has got to be a direct correlation—they are going to put money in that vehicle to get to work—and how that has impacted on the working family.

Mr. BERNANKE. Congressman, as I mentioned in my testimony, that is an important issue. The increases this year have been so great—or 2007 have been so great that conceivably it has had as much as half a percentage point of an effect on growth. And that really is a drag on the consumer going forward. So along—I should have mentioned that—along with housing, subprime issues, financial issues, that is another factor that is contributing to the slowing in the economy.

Mr. ETHERIDGE. And that being said, you know, the stubbornness of it staying there is, you know, is a confidence issue. And you keep seeing it on TV. And let me come back to the housing piece. You know, we talk about the subprime piece, but the truth is, as you spoke a few minutes ago, it has had an impact. I remember when my wife and I, we bought our first home. That was a big deal. It was a big deal for a lot of folks. And it still is today, as part of the American dream. That being said, with the drop in savings as we are having today—I was able to take benefit of the VA guarantee. And I am afraid today we aren't using those, and the FHA, as you indicated earlier. I think we need not forget the tremendous challenge we face, because the housing market is a tremendous mover in this economy. And you may not want to comment on this, but it seems to me we could take a hard look, we ought to be looking at the long term as well as the short term. And I agree with you, the three T's, timely, targeted, et cetera. But over the long haul, we need to look at our infrastructure in this country, not only roads and bridges, but also schools and other things that we could help facilitate that would help in downturns like this. I would be interested in your comments in this area for the long-term look as we look at our overall tax structure, looking at these pieces for public investment across America.

Mr. BERNANKE. Well, Congressman, you are putting out the case for the other side of what we have been talking about. I mean it is important to keep taxes low——

Mr. ETHERIDGE. No, I am not talking doing it now. I am talking about we ought to be looking——

Mr. BERNANKE. Talking about the long run. In the long run, we have to make that hard decision about how big a share of the economy we want to pass through the government. And there are valuable things the government can do. And that includes public infrastructure, for example. I agree with that. So on the other hand, you want to make sure that the projects you pick are highly productive ones, and will be useful and will be valuable. So that is the balancing act that only Congress can do, which is to balance the size of the tax burden against the size of those public spending elements.

Mr. ETHERIDGE. Thank you, sir. I yield back.

Chairman SPRATT. Mr. Scott. And I would say the same thing to you. If you could sort of shave your——

Mr. SCOTT. Thank you, Mr. Chairman. And thank you, Mr. Chairman. You know, it seems we have an agreement, we have been using the terms "timely, targeted, and temporary." Your remarks said it ought to be implemented quickly, be efficient, and be temporary. So I think we have an agreement as to what the framework ought to be. We have heard the fact that a $150 billion stimulus package would be minuscule in a $15 trillion economy, but I think you pointed out that if the growth rate is 2 or 3 percent, that $150 billion, just one little percent would change the growth rate 30 to 50 percent, which would be a significant impact on the economy. So that we ought not disparage—although it is just 1 percent, we ought not disparage the impact it could have. And we have heard comments about what—how quickly people would spend money if it were injected through the Food Stamp Program. They would spend that money almost immediately. Unemployment compensation would be spent immediately. Summer jobs to low income teenagers, I assume you would have the same comment about that, that would go right into the economy.

We have heard tax cuts as if all tax cuts were the same. You mentioned accelerated depreciation. The thing I like about accelerated depreciation, that over a 5- or a 10-year period, the corporation would eventually deduct the same amount of money. The only cost to the government is the time value of money. So that that is a very inexpensive way, particularly if you target it just to increases in capital expenditures over say a 5-year average so you are getting actual new spending and not just a—actually, you are rewarding a stimulus.

Could you say a word about capital expenditures, roads, new buildings, housing, or the gentleman from New Jersey mentioned investments in things like solar panels? I know the solar panel industry went out of business when the tax cuts expired. If we renewed the solar panel tax credit, not only would you have an incentive to get solar panels, but that industry, with all the jobs attendant to it, would come back into existence. Could you say a word about what effect capital expenditures might have?

Mr. BERNANKE. Well, on infrastructure generally or on solar energy-related spending, in terms of stimulus, as long as it is productive spending, that is positive. But the issue I would just want you to keep in mind is the time frame. And the question is, you know, whether the program you have in mind would be implemented, the funds disbursed, and result in actual spending and activity within the sort of 1-year time frame. If so, then it would meet those criteria that you mentioned.

Mr. SCOTT. Well, the thing I like about accelerated depreciation is when you pass the bill the spending gets done. The government doesn't actually spend the money until next year, when people take their deductions. So that is about as quick as you can get some money into the economy. We also heard you say tax cuts ought to be aimed at low and moderate income. And hopefully we will follow that admonition, too.

Mr. Chairman, out of respect to my colleagues, I will yield back.

Chairman SPRATT. Thank you very much. Mr. Chairman, we have two more questioners, two more people. If you could indulge us, if we could impose upon you for about 5 minutes.

Mr. BERNANKE. Certainly.

Chairman SPRATT. We will limit their time. And we would very much appreciate it. Thank you.

Ms. Schwartz.

Ms. SCHWARTZ. Thank you. And thank you, Mr. Chairman. And Mr. Chairman, I appreciate your giving us an extra few minutes. You have been really very clear today, and I really appreciate that very much, about how important it is to make sure that whatever we do, and there is a diversity of what we do, variety as you pointed out, that we do it quickly, and that we target it to, particularly on the individual side or the family side, to people who will put that money in the economy quickly. So I appreciate your saying that and making it really, really clear. And I have just one quick question about that, and I really wanted to focus on the business side of it if I could, because we haven't talked about that very much. We just started to with Mr. Scott. But just one quick question on the individuals or the family side.

Does it matter what they spend it on? I mean if they are spending it on credit card debt, are they spending it to pay their heating costs, if they are spending it to pay for health insurance premiums so they don't lose their health coverage versus other kinds of commodities rather than buying food or a new TV? I mean does it matter in terms of the economy?

Mr. BERNANKE. Well, you would hope they would spend it on things that are domestically produced so the spending power doesn't go elsewhere.

I guess I would add the point that although usually paying down your credit card debt is a negative in this kind of story because it doesn't involve immediate spending, I think given the financial pressures that we are seeing, broadly speaking, that reduced—people paying down debts, you know, has some benefits of its own.

Ms. SCHWARTZ. Okay. Well, I appreciate that, because I think, as you know, at other times we are trying to encourage people to think about those immediate expenses, and they are really stretched obviously, and just being able to meet those needs.

My question about some of the ideas that have been proposed on helping businesses be able to make the kind of investments, how do we make sure in that case as well that we—should we be targeting smaller businesses that might be more on the—more marginal in the sense of where they make capital investments? Would that be a smart thing to do? I assume it is important for us to make sure that they are doing—as well that they are going to go out there and spend the money rather than be money they spent last year, benefiting that—it wouldn't help at all, I assume. It has to be moving ahead and making sure that they are actually making those kinds of investments now.

Could you comment on that, and how we might be able to target those kinds—any kind of help we give to businesses to be able to spend those dollars to make those kind of investments? And is there any way for us to do it so that it might actually encourage them to create new jobs?

Mr. BERNANKE. I think Congress has already in the past structured these tax credits in ways that favor small businesses. And that reflects a value judgment on the part of Congress about where they want to provide the support. There may be some, but I am honestly not aware of any evidence on, you know, which type of business is most likely to invest given a tax credit. So I couldn't give you general advice about how to—you know, which type of business to favor. It is true, for example, though, that equipment is more likely—you know, there is a shorter lead time, can more quickly be purchased than a new building, for example. And so frequently these types of programs have an emphasis on equipment and software as opposed to structures. One would hope that this would involve new jobs. I think it would both directly and indirectly, indirectly in that the people who produce the capital then have more demand, and they would hire people, and that process would continue. And those companies that hire more capital and have more capacity may, although not necessarily, hire more workers to work with that capital.

Ms. SCHWARTZ. And just if you have a real quick comment, one of the other thoughts is that if we could speed up some of the public infrastructure projects. We did this once in Pennsylvania a number of years ago. We called Jump Start. It was on transportation projects actually, although it could be on school construction, it could be any number of things. Projects that are almost already in the works, so it is a short lead time to be able to try and speed that up so that that would put people to work. Is there any comment about that kind of public infrastructure?

Mr. BERNANKE. Well, the question is whether or not that can be done in a timely way. It would have—obviously, building things takes long lead times because you have to plan and design and get permits, et cetera. So it would have to be—and I am not sure how common this would be—something that was essentially ready to go but had been delayed and could be brought up more into the present. I don't know how often or frequent that kind of situation——

Ms. SCHWARTZ. But if it were practical we might be able to do that?

Mr. BERNANKE. If it were possible.

Ms. SCHWARTZ. Thank you very much.

Chairman SPRATT. We have to move ahead. The last questioner, member of our committee, is Ms. Moore of Wisconsin.

Ms. Moore, you weren't here, but the Chairman has to leave by 12:30, and we are almost imposing on his time already. If you could limit your time to 4 minutes, I thank you very much.

Ms. MOORE OF WISCONSIN. Thank you very much. Thank you for your generosity for being here today. We find ourselves in a conundrum here, because we—I think everybody appreciates the notion that we need to target our assistance to get down to low-income families and to help them. I guess my question is, you know, what vehicle? The vehicles that have been proposed don't really seem to be able to accomplish or achieve that. We have a 5.2 percent national unemployment rate. But when you disaggregate those numbers in my district, those people, for example, who are not receiving unemployment compensation insurance, but who have just given

up looking for jobs for the longest period of time, I find that 17 percent, three times, over three times the national average, 17 percent of white males in my district are unemployed, 23 percent of Hispanics in my district are unemployed, and 47 percent of African American men in my district are unemployed. Twenty-eight thousand African Americans in my district—we have the highest incarceration rate in the Nation—are under some sort of Department of Corrections supervision, and we really need to help them. They may not be heads of households because they don't have jobs, so food stamps are not going to help them. The unemployment compensation insurance will help some of them, but some of them have been unemployed for so long that even if we look back 6 months that may not help them. The low income heating program, that is a great vehicle. And if we give it to State and local governments, the only suggestions that have been made is that we help them underwrite their Medicaid program.

Can you tell me how we get this money—and I haven't even talked about the women who are on welfare and the time limits and the clock may hit them. Can you suggest for me some sort of vehicle to get the truly poor and the truly needy folk that I have described some of this assistance?

Mr. BERNANKE. Congresswoman, you have put your finger on an important problem. You have listed most of the vehicles that people could think about. If we want to get the money out quickly, you know, the easiest way is to go through the tax system or one of the existing programs. I don't have a good suggestion for you.

Ms. MOORE OF WISCONSIN. And these are not tax filers. Don't you agree it would be really a bang for the buck if we could figure out how to get assistance to these people? I mean there are—it is not like we don't have lists of these people who have in the past received general assistance through the counties. It is not like we don't know who these 28,000, for example in my community, men are who are on probation, living with their mommas, living with their sisters, living with a live-in girlfriend. It is not like—and living off them. So it is not like we don't know who they are. But I just want to hear that it would be worth the effort to try to figure out a vehicle to help these folks in terms of the impact of an economic stimulus.

Mr. BERNANKE. I do want to draw a distinction, which is that we need to address these problems as part of long run policy. I mean obviously poverty is a problem. And there is a whole, you know, range of things that could be done and should be done to try to address it. We are not going to fix that with, you know, with a check, with one check. So we clearly want to make that part of our long-term policy issue, policy priorities.

With respect to current fiscal stimulus, as I said, the evidence does suggest, and I have said a number of times, that low and moderate income people are more likely to spend the money in the near term. So from the fiscal stimulus point of view, there is some benefit to finding ways to providing money to people in that category. Timeliness, though, is an issue, and we need to find ways to do it, you know, that will not take us, you know, well into 2009.

Ms. MOORE OF WISCONSIN. Thank you. And thank you, Mr. Chairman.

Chairman SPRATT. Mr. Chairman, thank you very much indeed, not just for your clear and helpful answers, but for your patience and forbearance. You have added to our knowledge of the subject matter. We said we would come here looking for your advice and guidance about how to do this, if we do it, and you have given it to us forthrightly. And we very much appreciate that. Thank you.

Mr. BERNANKE. Thank you, Mr. Chairman.

Chairman SPRATT. One final housekeeping matter before wrapping up the hearing. I ask unanimous consent that members who did not have the opportunity to ask questions of the witness be given 7 days to submit questions for the record.

[Question for the record submitted by Ms. DeLauro follows:]

QUESTION SUBMITTED TO CHAIRMAN BERNANKE FROM CONGRESSWOMAN DELAURO FOLLOWING THE HEARING

Question: Henry Kaufman, who spent 26 years with Solomon Brothers where he served as the managing director and the last 20 years where he has been president of Henry Kaufman & Company, warned in the Wall Street Journal back in October that the subprime is only part of a far larger problem in the way our credit markets function. Kaufman argues that the Federal Reserve and U.S. Treasury Department have failed to keep pace with fundamental changes in the market. He states, "Today's regulatory system is largely a historical artifact left over from the era when financial markets and institutions were much more fragmented and insulated from one another." Can you comment on Mr. Kauffman's observation and whether you believe The Fed, under your predecessor, was negligent when it failed to regulate private sector players, such as Goldman Sachs, who were making these subprime loans and packaging them into risky securities that ultimately failed? In light of fact that the Fed's inaction helped create the crisis, what do you plan to do as chair of the Fed to fix the problem and prevent it from happening in the future?

Answer: I agree with Mr. Kaufman that the manner in which credit is provided to businesses and to households has changed substantially in recent decades. Whereas commercial banks used to be the primary source for many businesses or households, a considerable volume of credit is now intermediated through the financial markets. As with banks, investors in private financial securities have strong incentives to understand the credit risks to which they are exposed. Nonetheless, it has become evident that, in the past couple of years, some market participants failed to perform adequate due diligence, particularly in regard to investments in a variety of structured finance products. Too many investors seemed to rely heavily on the risk assessments of others and apparently were complacent about their exposures.

A variety of private and public efforts are underway to address the revealed deficiencies. Ratings agencies are reevaluating their methods for rating structured finance products and considering significant changes to how credit risk on those products will be communicated to investors. Regulatory oversight of the mortgage industry has become more challenging as the breadth and depth of the market has grown over the years, and as the role of nonbank lenders, particularly in the subprime market, has expanded. To address this challenge, the Federal Reserve, together with other federal and state agencies, launched a pilot program last summer to conduct reviews of consumer protection compliance and impose corrective or enforcement actions, as warranted, at selected non-depository lenders with significant subprime mortgage operations. In December 2007, the Federal Reserve used its authority under the Home Ownership and Equity Protection Act to propose new rules that address unfair or deceptive mortgage lending practices.

The proposal addresses abuses related to prepayment penalties, failure to escrow for taxes and insurance, stated-income and low-documentation lending, and failure to give adequate consideration of a borrower's ability to repay. Our proposal is comprehensive, covering most mortgage loans with certain protections and the entire subprime market with other, more specific regulations. In addition, we drafted the proposal to ensure that protections remain strong over time as loan products and lending practices continue to evolve.

The Federal Reserve works closely with other government agencies to promote the efficient functioning of capital markets. As you know, the Federal Reserve System has supervisory and regulatory authority over bank holding companies, state-chartered banks that are members of the System, foreign branches of member banks,

and U.S. branches of foreign banks. We do not have supervisory or regulatory authority over broker-dealers or their holding companies; that authority rests with the Securities and Exchange Commission.

There being no further business, the committee is adjourned.

[Whereupon, at 12:39 p.m., the committee was adjourned.]